

Much like Private Ryan, private industry (or vast sections of it) feel like they are caught in the teeth of battle during WWII.

Make no mistake, the parliamentary encounter we have experienced to date was a mere skirmish. The real political battle for the hearts and minds, not to mention the redistribution of wealth and income, has just started in the real world.

Since the details of the carbon tax scheme are covered in mind-numbing detail in all the major papers, broker notes, etc, let me concentrate my comments on a few aspects I think are relevant for investors. Make no mistake, this is a VERY big deal.

My she is yah! (Philadelphia Story)

Because the bulk of the compensation comes via adjustments to the personal income tax scales, the package achieves a high level of efficiency. (Whether offering relatively high levels of compensation precludes any alteration to individual behaviour is another matter). It also tangentially addresses some issues about the cost of transitioning from welfare to work, which is to be applauded.

More questionable is the formation of the \$10 billion Clean Energy Finance Corporation. This is essentially a government administered handout scheme to encourage renewable energy development. The problem being by its very nature it must attempt to pick winners and if previous schemes are anything to go by, judgement and efficiency are not strong suits for the public service, not to mention execution.

Basic Instinct

This carbon tax/trading scheme, politics aside, is fundamentally supposed to be about changing behaviour, right? So, basically you need to change consumer and/or business behaviour. If you are fully compensating two thirds of consumers and the rest (if we believe the modeling) are high income earners who are circa \$10 a week worse off; care factor zero. So that leaves business.

Well 500 companies will feel some serious pain, but the positive and negative comments have come out strictly in line with vested interests. So those screaming loudest (coal miners, manufacturers, etc) say their compensation is inadequate. Maybe. Those fawning over the package (steelmakers, etc) have clearly been well compensated - despite questionable comparative advantage on the global stage.

My biggest issue with this venture is that if you don't seriously attempt to change consumer behaviour then you MUST change business behaviour. OK so the package penalises heavy polluters, but where are the serious incentives to invest in new base load power generation?

No, not "green" power. If you rule out nuclear, then the only serious options for base load power to do the heavy lifting are coal or gas. Sequestration of carbon from coal fired power stations might be viable some time in the future, but for now if you are paying brown coal fired power stations in Victoria to shut down surely you need to provide incentives for investors to back gas alternatives.

Simply focusing on eliminating what you don't want (ie coal) doesn't mean the alternative you do want magically appears. Sure, as an investor the relative attractiveness of gas increases. But relative to other investment alternatives (simply shipping the stuff to China, gold, rare earths, whatever) the gas fired generation may not get the dollars. Every investment decision is relative. It's about return on equity, not whether Joe and Jill Bloggs can heat their house.

Australia is leading the world in carbon reduction!

Seriously? Or are we taking a high risk path with questionable impacts on the global carbon footprint?

One big economic issue is that studies by the Productivity Commission* focused on our major trading partners and found our action was not out of kilter. True.

Saving Private Industry

Market Update on Carbon Tax Scheme



Problem is they are not our competitors. By definition countries trade for mutual advantage - when they both have something the other wants. None of the world's major energy exporters have a serious carbon reduction scheme. Result - serious competitive disadvantage for us until the rest of the world catches up.

Morally the intent is unquestionably correct. Economically it is a high risk path that creates massive dislocation industry by industry; massive winners in renewables, massive losers in fossil fuels, transport, etc. As Dr Ziggy Swikowski was quoted as saying in the Australian, "We will throw out our historical competitive advantage in energy to pursue a noble goal of reducing our carbon emissions - no other country has done this."

Certainty

Although we now know carbon emissions will be initially taxed at \$23 per tonne, it is arguable that uncertainty has increased rather than reduced following Sunday's announcement. This is particularly apparent when the opposition leader is fiercely campaigning on the platform of rolling back the tax.

With the increasing competitive disadvantage on local companies combined with the incredibly strong Australian dollar, it just reinforces my view that there are far better opportunities for investors in global equities than at home.

Article Source: Matthew Drennan, Zurich Financial Services Australia

This information is derived from sources believed to be accurate as at this date, which may be subject to change. It should not be considered to be a comprehensive statement on any matter and should not be relied on as such. For individual advice on your financial situation please see a wealth management adviser.

Dated July 2011

