

NATIONAL CLIMATE CHANGE SAVINGS SCHEME

A Contractionary Fiscal Policy as an alternative to Monetary Policy

Aim of the Policy

To reduce the need for, and adverse impact from, a rise in interest rates during a period of high demand that could lead to increased inflation; and substitute it with a national savings scheme that would promote the application of renewable energy and water saving devices; in a socially and economically responsible manner.

The policy itself would potentially have three different facets. Each can be implemented as a stand alone policy. The acceptance of any one will provide a benefit; however, implemented together provides a complementary, cohesive and coordinated approach to reducing current demand within the economy, to reduce the need for interest rates rises and to generate funding within the economy to implement climate change infrastructure on both an individual and organisational basis.

This policy is complementary to an Emissions Trading Scheme it is independent to it and does not replace it. They focus on different aspects. This policy will enhance the ability of the economy to implement the ETS both by ensuring the health of the economy and by directly accumulating funds for it as well as other actions to reduce the emission of green house gases.

Summary of the Policy

Classical Monetary Policy raises interest rates to curtail excess demand and reduce pressure on prices and inflation. While it has an impact on Demand Pull inflation it risks generating Cost Push inflation through a wage price spiral. Monetary Policy is regressive; hurting families, people on lower incomes, struggling businesses and in periods of drought the farming sector. Increasing the international interest rate differential puts upward pressure on the Australian Dollar which has a detrimental effect on the economy hurting: manufacturers who are exporting or import competing; mining; farming and tourism.

There is an alternate mechanism that can soak up excess demand similarly to interest rates; but unlike interest rate policy which is a blunt instrument, it relates to incomes not borrowings and can therefore exempt families on low incomes and businesses and farmers in difficulty. While the scheme is legislated, the operation is enacted by the Reserve Bank in conjunction with Monetary Policy and is therefore independent of Government control. Unlike interest rates which are only a burden, the funds removed from individuals and companies remains for their benefit. The Scheme is called the National Climate Change Savings Scheme. Funds saved will be used by families and companies, when sufficient is accumulated and access is granted by the Reserve Bank, to purchase infrastructure to help environmental and climate change projects such as: the use of solar panels; the differential between hybrid and petrol cars; water tanks etc. As it is an asset not a cost and does not affect the interest rate differential, it avoids most of the downside of monetary policy, achieves much of the benefit and at the same time provides a future benefit to families, businesses, the economy and to our climate change commitments.

In addition to the contributions mandated by the RBA, it is suggested that there be two additional facets: the first being mandated by the Government coinciding with the tax cuts with lower income levels exempt; the second being voluntary contributions with accompanying tax concessions.

National Climate Change Savings Scheme Policy

The introduction of a National Climate Change Savings Scheme in which individuals and companies will both be encouraged and compelled to save funds to facilitate their own future investment in infrastructure for Climate Change or Environmental Purposes.

For further detail and a comparison with classic interest rate policy refer:

Attachment 1 – Key Evaluation Criteria - Interest Rates Monetary Policy Vs NCCSS Fiscal Policy

Attachment 2 – Operation of National Climate Change Savings Scheme

Attachment 3 – Reserve Bank Responsibilities

It is implicit and essential to the policy that at all times funds collected remain the property of; to be used for; and at the direction of the contributor. This is essential to achieve widespread support and to diminish any downside.

The implementation of a tax, a levy or raising interest rates is a burden that takes the contribution or funds away permanently. This is not a tax, a levy or any kind of burden on the individual that they lose. It is not an expense that reduces profits and profitability. It is savings that will be used by the contributor for their own benefit, which by its own nature helps the whole country and the world by the reduction of the emission of greenhouse gases.

Because it is not an expense or a tax but an asset both as savings and when invested into capital equipment it does not diminish the valuation of a company or its performance and therefore should not adversely affect Stock Exchange values or managerial performance measures; and so unlike interest rates should not provide upward pressure on prices to recover their position.

Because it does not take anything permanently away from individuals and families and will be used for their own benefit; potentially is only a short term measure; potentially will prevent further interest rate rises; and has a positive impact on climate change, it has the potential to be politically acceptable and accepted as part of an accord moderating wage demands.

The scheme has three facets:

- the provision of a fiscal policy to the RBA to complement monetary policy to better facilitate their ability to meet their functional objectives for the economy;
- a specific contribution determined by Government coinciding with but separate to the tax cuts; and
- voluntary contributions with tax incentives.

Current Situation

Inflation is currently being touted in the media as one of, if not the greatest challenge facing Australia and the Rudd Government today.

Similarly Climate Change is a major issue. We have an international commitment to reduce Australia's emissions of Green house gases with a reduction of 60% of 1990 levels by 2050 which officially delays the inevitable, but nevertheless there are increasing pressures for short-term targets and implementation of environmentally sound practices. Bali seeks emissions cuts by 25-40% of 1990 levels by 2020. The introduction of an emissions trading scheme will assist its achievement. The policies recommended here will complement it and help provide funding for it.

For a significant period inflation and interest rates have remained low. This has led to expectations of a continuation of the same which has facilitated wage restraint and diminished

the need for price increases. Increases in incomes and profits have largely come from productivity increases and increased turnovers.

The economy has recently been affected by capacity constraints, petrol price rises, drought, flow on effects, and interest rates. Wage rises are increasingly being sought to recover their position, which in turn will further stimulate price rises, interest rate rises and the potential for a wage price spiral to be institutionalised into expectations.

Raising interest rates can reduce excess demand, which can reduce upward pressure on prices in the areas in which there is a shortage in supply. The deficiency of interest rates is that an entire economy will carry a burden regardless of whether or not they are contributing to the surplus demand. It can generate significant hardship for individuals and organisations that are overburdened with debt and has the capacity to cause significant dislocation and reduction of capacities through bankruptcies, businesses closing down partially or completely and families losing their homes; as well as the direct stimulus toward creation of a wage price spiral. Once entrenched in expectations this will take on a momentum of its own.

The Rudd Government is appropriately committed to implement the tax cuts that have been promised. If long term Budget Surpluses are forecast and debt repaid there is an obvious argument for lowering taxation. Not to fulfil a major election promise would be extremely damaging to the new Government's credibility. To deny the tax cuts may stimulate an angry electorate to seek even higher wages to recover their position that would be even more damaging to the economy than to deliver tax cuts. However, to allow the tax cuts to flow into the economy as increased demand at this time is likely to result in the RBA further increasing interest rates and leaving the economy and the electorate in a worse position than if the tax cuts were never granted. We are therefore in a lose-lose situation.

However, just as there is an alternative to the RBA using interest rates to slow demand, there is another way to deliver the tax cuts but to limit the inflationary impact at this time.

The alternative is the implementation of a contractionary fiscal policy that would have wide spread public acceptance and support.

Obviously a difficult task, but one which is nevertheless achievable. The concept of a National Climate Change Savings Scheme has been researched over a significant cross section of the community as well as those with relevant expertise and has generated such support.

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**Attachment 1 - Key Evaluation Criteria - Interest Rates Monetary Policy Vs NCCSS
Fiscal Policy**

Issue	Interest Rates - Monetary Policy	NCCSS - Fiscal Policy
1. Economic viability / responsibility	<p>A classical approach to reduce excess demand; but cannot be targeted, so generates significant hardship to segments of the economy. Is purely an economic burden to slow demand and can damage capacities and social structures. Is operated by the RBA for independent control.</p> <p>At a time when the economy needs to react to the challenge of climate change, it diminishes not enhances the ability to respond.</p>	<p>An innovative approach to reduce excess demand; can be targeted as it is applied against income and profits not mortgages and other loans its commencing levies can be set to prevent hardship and loss of capacity.</p> <p>Is recommended to be operated by the RBA for independent control.</p> <p>It directly builds funds to enhance the ability to react to the challenge of climate change, when funds released by the RBA</p>
2. Direct impact on inflationary pressures – Demand Pull	<p>By raising the cost of funds, it reduces the discretionary expenditure available by increasing the burden of existing borrowings and makes additional borrowing less attractive.</p> <p>It raises the return to those lending so increases their capacity for discretionary demand.</p> <p>If the after tax return on savings is greater than the rate of inflation there may be a greater stimulus to save rather than spend.</p> <p>If it generates expectations of a wage price spiral it can stimulate purchases, with “buy now on lower prices, pay later from higher incomes”.</p>	<p>By enforcing savings into this special purpose fund it directly reduces funds available for discretionary expenditure.</p> <p>It has no direct impact on the cost of money.</p> <p>Because no funds are removed from the contributor and “at risk” socio-economic segments are exempt it may be possible to apply a temporary heavier load than would be palatable using interest rates alone, generating a better impact.</p>
3. Direct impact on inflationary pressures – Cost Push	<p>The increased cost burden on companies is yet another factor to encourage them to raise prices.</p> <p>The prospect of ongoing higher interest rates and as the extra cost is a permanent burden it encourages workers to seek higher wages to recover their position, which in turn becomes a cost factor stimulating further price rises, toward a wage price spiral.</p>	<p>It is not a permanent burden to either companies or individuals. The funds remain for their own benefit for future expenditure / investment that will reduce future costs or enhance revenues.</p> <p>It does not entrench higher interest rate levels.</p> <p>There is therefore a greater probability of wage and price restraint under this policy.</p>

Issue	Interest Rates - Monetary Policy	NCCSS - Fiscal Policy
4. Impact on company profits	As an added cost, it directly reduces profits.	As it generates an asset, it has no effect on profits until equipment is purchased and then depreciation is incurred which potentially is at least matched by a cost reduction or income generated.
5. Impact on taxation and budget surplus	Reduced profits reduce taxes and budget surplus	No impact, as no impact on profits.
6. Impact on Exchange rates.	By increasing the disparity between Australia's and international exchange rates, there is upward pressure on our exchange rate. Following Sub Prime overseas rates have reduced, Australia's have increased. A strong Australian dollar hurts tourism, farming, exporters, and import competing manufacturers and encourages more imports.	No impact as does not affect interest rates. If applied in conjunction with an interest rate reduction can reduce the upward pressure on the Australian dollar.
7. Impact on: lower income earners, struggling companies, farmers struggling from the drought.	Anyone with excessively high gearing on their borrowings not only have discretionary income soaked up, but can be placed in a situation of extreme hardship and potentially foreclosure of loans resulting in loss of homes, farms and businesses and productive capacity closed. Can only be negated by Government assistance.	Legislation determines minimum income and profit levels before an impact is applied. Therefore there is far less risk of adverse impact leading to loss of capacity, homes, and social dislocation.
8. Ability to target or protect different socio-economic sectors from adverse impact.	None. It is applied on a macro-economic basis only. Protection then comes from alternate fiscal policy e.g. enhanced grants for first home buyers – in conflict to the policy itself.	Defined into the legislature to provide specific protection.
9. Nature of burden	An interest cost, which becomes a redistribution of wealth from borrowers to lenders.	Generating savings which will be used in the future to assist the contributor.
10. Impact when policy reversed. Ability to stimulate demand if a recession has been generated.	Lowering interest rates reduces the burden. It will not necessarily lead to enhanced demand. Often mortgages will have been extended which will then need to be reduced before demand resumes. A recession creates concern over job security and company sales.	Lowering interest rates reduces the burden. While mortgages may have been extended and concerns relate to sales and security there are funds that have been saved that now can be spent, but only on climate change not on general costs. This pent up demand can help kick start the economy. The decision to release funds or reduce new savings are independent decisions as is interest rates, therefore the method of re-invigorating the economy can be controlled via all three facets.

Issue	Interest Rates - Monetary Policy	NCCSS - Fiscal Policy
11. Potential application of funds.	None.	Anything that the Government stipulates in the relevant schedule that assists climate change or water saving, for example: Solar panels; the price differential between petrol and hybrid cars; water tanks; reticulation of grey water; emissions trading credits; investment into companies/projects that have climate change impact such as producing wind/ wave/ solar/ geothermal power, infrastructure to produce hybrid cars etc (similarly to that for the film industry).
12. Benefit for contributors when savings are permitted to be used.	None.	Reduced costs or enhanced income resulting from purchases in the item above.
13. Beneficial impact on climate change / the environment after utilisation of funds.	None.	Reduction of emissions by enhanced production of clean energy, reduced demand for energy; and reduced demand for fresh water either reducing shortages or facilitating increased flows to rivers.
14. Comparative impact on economy for future requirements of climate change expenditure.	Reduces discretionary expenditure, increases debt, making it more difficult.	Directly provides funds to implement climate change strategies.
15. Political acceptance	Disliked	Consistent with public sentiment and retains self interest. Research has shown widespread support.

Attachment 2 – Operation of National Climate Change Savings Scheme

1. Reserve Bank operated to control inflation.

Mechanism

The level of savings in a “quotient” required to be contributed would be legislated by Government. The amount of quotients required would be enacted by the RBA just as it raises interest rates by 0.25% or more on various occasions in an endeavour to control inflation.

There are two alternatives both apply against incomes and profits:

1. The first is simply to determine a level of savings in relation to income and profits;
2. The second is to relate the function to that of the RBA in controlling interest rates and provide a deemed level of borrowings per income level to which the RBA provides their interest multiplier to determine the quotient.

1.1 Mechanism simplified to Income.

A suggested illustrative table would look something like the following:

ILLUSTRATIVE EXAMPLE ONLY

Individual Annual Salary	One Quotient %	Annual Savings	Fortnightly Savings
\$40,000+	0.50	\$ 200.00	\$ 7.67
\$60,000+	0.70	\$ 420.00	\$ 16.11
\$80,000+	0.80	\$ 640.00	\$ 24.55
\$100,000+	0.90	\$ 900.00	\$ 34.52
\$140,000+	1.00	\$ 1,400.00	\$ 53.70
Company Annual Profit	One Quotient %	Annual Savings	Monthly Savings
\$50,000+	0.75	\$ 375.00	\$ 31.25
\$100,000+	1.00	\$ 1,000.00	\$ 83.33
\$250,000+	1.25	\$ 3,125.00	\$ 260.42
\$500,000+	1.50	\$ 7,500.00	\$ 625.00
\$1,000,000+	2.00	\$ 20,000.00	\$ 1,666.67

Note quotient applies from break point, savings shown at that level.

Note also that the rates are deliberately different from this to the next example to highlight it is a commencing discussion point and not a final recommendation.

1.2 Mechanism related to mortgages and borrowings.

An average mortgage is said to be \$300,000. This means that an interest rate rise of 0.25% takes approximately \$29 per fortnight from individuals. Of course there is a distribution around this average. However, there is no direct correlation between the size of mortgage and other borrowings to income level. While higher incomes allow more expensive preferences and therefore greater borrowings they also allow a greater capacity to repay debt. A policy relying solely upon interest rates can be very regressive.

Just as the government legislates varying breaks in relation to income for Reasonable Travel Allowances; marginal tax rates; family tax benefits etc, it could apply a "deemed mortgage level" to an "income earned". The Reserve Bank would then set the intensity of the rate. The following table is simply illustrative, not prescriptive.

The commencing income rate could well be set higher, the mortgage rate set lower and the number of income levels reduced.

I emphasise that the application of this policy impacts solely on the discretionary income and expenditure of people actually earning. Interest rate increases impact on borrowers who may have no discretionary income, such as the unemployed, pensioners, and others in hardship who have borrowings and pay interest; on the other hand, middle and high income earners may have no borrowings and interest rate increases have no effect on their expenditure.

ILLUSTRATIVE EXAMPLE ONLY

Annual Income \$	Deemed Mortgage \$	Approx fortnightly contribution per 0.25% interest rate - \$	Annual Savings for climate change purposes - \$	Percent of Income %
38,000	80,000	7.67	250	0.66
45,000	130,000	12.47	325	0.72
55,000	180,000	17.26	450	0.82
65,000	230,000	22.05	575	0.88
75,000	274,000	26.27	685	0.91
100,000	366,000	35.09	915	0.92
150,000	550,000	52.74	1375	0.92
200,000	750,000	71.92	1875	0.94
250,000	1,000,000	95.89	2500	1.00

In the above table:

Annual Income is considered as being Net Disposable Income. Suggested as total income person exclusive of superannuation, family tax benefits etc and include 50% of capital gains which have not been rolled over into new investments.

Deemed Mortgage is per person; so that two income earners per household adds additional mortgage value. For example, a household with one person earning \$65,000 pa and a second at \$38,000 pa a total of \$103,000 pa would be deemed at the equivalent of a \$310,000 mortgage contributing \$825 pa or 0.80% of household income.

For individuals my illustration commences at \$38,000 and allocates 0.66% of Net Disposable Income per 0.25% interest rate replacement, then rises to 1.00% of income at \$250,000. Similarly for companies I'd deem a "level of borrowings" in relation to profits. I'd suggest a level of approx 1.0% for companies earning profits from \$50,000 pa i.e. \$500 pa rising to 1.25% for companies earning above \$250,000; and 1.5% above \$500,000. This applies the impact of the policy to companies that are likely to be spending and not against companies that could become bankrupt from high interest costs. In this manner we are not destroying capacity or value. For multinational companies capable of internal transfers and avoidance mechanisms, I'd add back items such as internal management fees when determining their "deemed borrowings".

There is considerable public sentiment in relation to environmental issues. While nobody appreciates money taken from them, to the extent that it is placed in a savings fund on their behalf, to achieve future cost reductions for their benefit; and is a temporary cost, not a permanent one, it is likely to be more acceptable and moderate behaviour by individuals otherwise seeking to recover it by wage rises and by companies with price rises.

Collection

The system would take funds through the normal Taxation system no differently than PAYG or BAS generating an immediate impact on liquidity as does an interest rate rise.

Recording

I would use the existing computer facility that maintains tax records, to maintain the individual balances for each contributor. The system currently monitors and retains records for individuals on an ongoing basis in a variety of areas such as "Family Allowances and Tax Benefits", "Prior Year losses carried forward" etc. With incremental modifications the cost should be minimal within the current system.

Funds management

I would have the existing managers of the Futures Fund manage these funds; bearing in mind the differential liquidity requirements of this fund for interest bearing deposits vs. more aggressive investments for long term investments.

Vesting of Returns

To the extent that the fund earns a profit I would distribute to the contributors in line with inflation to maintain the net preset value of their contribution. To the extent that the fund earns above the rate of inflation I would use this as grants to assist low income households, Not-For-Profit organisations etc to implement environmental equipment practices, particularly via matching contributions.

Matching Contributions

The Government matches contributions for superannuation of up to \$1500 to encourage extra savings, up to a certain income level then reduces it pro rata beyond that; similarly it provides a Family Tax Benefit to a certain level then phases it out. To the extent that Budget Surpluses allow and the dedicated fund achieves excess profits, I'd apply matching contributions to that of low income contributors to further facilitate their participation in environment enhancing devices. An example would be doubling the contribution of those earning up to \$45,000 phasing down to nil at \$75,000.

Intensity of Application

While the Government would establish the scheme and parameters, the Reserve Bank would determine the factor applying at any one time i.e. 0.25%, 0.5% etc. It would do this in conjunction with interest rate policy and may simultaneously increase the rate applicable to the National Climate Change Savings Scheme while reducing the rate applicable to interest rates. The rationale being:

- that savings for investment into Climate Change Infrastructure is better than an interest rate burden;
- that it spreads the burden from borrowers to earners; from those that can least afford it with little discretionary income, to those that can afford it with higher discretionary income and therefore those that most contribute to demand pull inflation.
- That it reduces the interest differential between Australian and Overseas rates reducing upward pressure on our exchange rate.

Utilisation of Savings Funds

The decision on how to spend the funds from individual Climate Change Savings Accounts is by the contributor alone. However, Government would determine the class and nature of eligible items. For example:

- Solar Panels on houses, factories, offices etc which would generate renewable energy electricity. This benefits the contributor by reducing their expenditure on electricity or by providing an income when fed back into the grid; producing in excess of their needs.
- Water Tanks particularly with reticulation into suitable grey water areas such as toilets.
- Hybrid cars-petrol/electric. If the price differential on a hybrid to a petrol car is say \$10,000 I'd allow the differential as an allowable deduction. (*Source Toyota website-Corolla Conquest Hatchback 1.8 litre 4 speed auto from \$27,000 Prius 1.5l petrol/electric from \$37,400 Prius fuel economy 4.4 litres per 100km.*)
- Investment in companies that are directly contributing to climate change by investing in infrastructure such as for producing clean energy - solar, wave, geothermal or wind etc or research such as clean coal technologies. Precedent rules can be borrowed from investment in films and innovation research from the TCF industry assistance scheme.
- Purchase of emissions trading credits.

Refunds

The mechanism for providing refunds from the contributor's savings account for both capital equipment directly purchased and installed or for carbon credits purchased would be through the existing electronic tax system. Monitoring and record keeping would be self assessment as per the rest of the tax system.

The system functions effectively and promptly for PAYG on an annual basis, and within the BAS system, companies that predominantly sell GST Free goods submitting monthly returns also receive regular refunds promptly.

Lags and Time Constraints

To the extent that funds collected need accumulation before they can effectively be spent there is a natural lag. For example, an individual contributing \$750 pa needing \$3000 for a specific purpose, needs four years' accumulation before expenditure is possible. However, to the extent that its expenditure will be chasing scarce resources and therefore stimulating inflation, the Reserve Bank would be able to mandate the temporary freezing of funds and the timing of release.

Transferability

While the intent is to effect better environmental practices directly for the benefit of the individual contributor, this may not always be possible or produce the best outcomes. If a legitimate market is not created; informal mechanisms may still occur.

- Those who rent, use public transport and otherwise have limited opportunity for beneficial environment enhancing purchases have a legitimate need to transfer.
- Those who will benefit more from a discounted return, transferring funds, still contribute to the goal of saving water or reducing greenhouse gases as that is the only ultimate permitted end use of the funds. A discounted cost to the purchaser accelerates positive environmental capacity.

Except where the transfer occurs within specifically defined relationship groups, the ability to transfer should be delayed until the increase in liquidity is advantageous to the economy.

Implementation

Sections 11 & 13 of the [Reserve Bank Act 1959](#) require the [Reserve Bank Board](#) to engage in frequent formal and informal contacts between the Governor and each of the Treasurer and the Secretary to the Department of the Treasury. If there is any short term legislative difficulties formally delegating this new authority to the RBA; it may be implemented more quickly via other Government processes, consulting with the RBA through the through the normal legislated process, who would then operate monetary policy taking such actions into account.

2. Initial implementation coinciding with Tax Cuts to control inflation.

Mechanism

As the tax cuts are going to be inflationary which may result in the RBA required to increase interest rates in an endeavour to control inflation. The result of this and any flow on effect is likely to leave taxpayers in a worse position than if they were not applied. The Tax cuts should still be implemented but from a commencing level of say \$50,000 or \$55,000 for individuals and \$80,000 for families; an equivalent value to the tax cut would be deposited into the taxpayer's Climate Change Savings Account.

The effect of this is to cushion the effect on low to lower middle income earners, from whom reducing demand just generates hardship; however it prevents excess demand being exacerbated by the tax cuts and stimulating further inflation.

To cushion the economy, the funds contributed could be initially frozen for between twelve (12) months to two (2) years then progressively released, with an ongoing defined lag giving the economy time to adjust to meet the increased demand. When the threat of inflation is over, or there is other reason to stimulate the economy, initially all time lags could be revoked; subsequently the imposition of the tax cut matching contribution also be revoked, which of course leaves the tax cut in place, because it was given and not renege upon.

3. Voluntary contributions to control inflation.

Similarly to superannuation, there can be benefits to both the economy and the individual for making additional contributions into the National Climate Change Savings Scheme.

As it is purely voluntary there would be no limits or requirements to contribute. In both the previous options contributions come from after tax income as per the component they replace. Voluntary contributions come from pre tax income and would attract a suggested 15% tax at the time of contributing and a 15% tax on earnings as per superannuation.

The contributions would be capable of being saved into a special purpose fund within all complying and participating Superannuation Funds or into the individual's account established within the National Climate Change Savings Scheme. All fund earnings to the contributor's account.

The funds would be frozen for a period of time say three (3) to five (5) years after which it could be used for any of the defined climate change purposes. Should the contributor wish to use the funds earlier, they can be withdrawn and used for climate change purposes with an additional tax payment of 15%; if they are desired for other purposes subject to any other stipulation on qualifying period or maximum percentage permitted (because of the beneficial accumulation rate); amounts withdrawn would be taxed at the taxpayer's marginal tax rate less a 15% allowance for the tax already paid.

Attachment 3 – Reserve Bank - National Climate Change Savings Scheme

“It is the duty of the Reserve Bank Board, within the limits of its powers, to ensure that the monetary and banking policy of the Bank is directed to the greatest advantage of the people of Australia and that the powers of the Bank under this Act and any other Act, other than the Payment Systems (Regulation) Act 1998 and the Payment Systems and Netting Act 1998, are exercised in such a manner as, in the opinion of the Reserve Bank Board, will best contribute to:

- (a) the stability of the currency of Australia;***
- (b) the maintenance of full employment in Australia; and***
- (c) the economic prosperity and welfare of the people of Australia.”***

To reduce inflation, the classic response is to increase interest rates.

- (a)** To the extent that this causes the differential between Australia’s and International interest rates to rise, which in turn attracts capital inflow and upward pressure on our exchange rate, particularly during a Sub Prime crisis when the US Fed, UK and Canada amongst others have reduced interest rates; **how does this contribute to the stability of the currency of Australia?**
- (b)** When the interest rate burden becomes unmanageable and businesses that were struggling with current profitability or cash-flow are forced to close or significantly retrench, **how does this contribute to the maintenance of full employment in Australia?**
- (c)** When the interest rate burden becomes unmanageable and families cannot repay their mortgages and lose their homes; when people on lower incomes with mortgage repayments taking an excessive proportion of disposable income can no longer pay medical bills or put adequate food on the table as they struggle to meet their commitments and prevent bankruptcy; **how does this contribute to the economic prosperity and welfare of the people of Australia?**

The obvious answer is that it does so only because the consequences upon these and others would be worse but for the action taken. Hence it is the lesser of two evils.

The biggest problem with monetary policy and interest rate rises is that it provides only a broad brush approach. It can have no discretionary impact. There are fundamentally two types of inflation, demand pull and cost push.

Increasing interest rates is designed to reduce discretionary expenditure, to soak up excess demand that is otherwise stimulating price increases, thereby reducing inflationary pressures. Excess demand exists where the demand exceeds supply; yet increasing the cost of money impacts those with borrowings which is not the same as impacting those people with a high discretionary component to their income. It is indeed a perverse policy that chooses to control demand by imposing the greatest burden on those who are least consuming.

Increasing interest rates intrinsically add to the pressures already felt by those impacted by higher prices. To the extent that unemployment levels remain low and the labour market remains tight this in turn stimulates demand for higher wages. The impact of the initial inflation on operating costs; higher interest rates; and increased wage demands combine to generate cost push inflation. To the extent that expectations change because inflation is perceived as the norm rather than price stability, we risk institutionalising a wage - price inflation spiral.

However, the provision of a fiscal policy in the form of the National Climate Change Savings Scheme to the RBA to complement monetary policy will better facilitate their ability to meet their functional objectives for the economy.