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TITLE: Someone's silver lining

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Prime Minister Kevin Rudd's announcement that the carbon price is now a quarter of what was forecast is good news; the question is, for whom?

Rather than crippling, the impact of the carbon price is barely even irritating for most polluters. Compared with the impact of the high exchange rate since 2007, the carbon price was trivial even before this week's announcement.

The lower than expected price means we could set much more ambitious emission reduction targets, and achieve them at the price we thought we would have to pay for the trivial targets. That is, having learnt that tackling climate change is cheaper than we feared, we could choose to buy a lot more of it. Of course, the big polluters think we should stick to the timid targets and let them enjoy the cheap permit prices, but they would think that.

Markets often seem more complex than they really are. While no one can explain why some toothbrushes cost more than a digital watch, pretty much everyone knows that when you flood a market with too much supply the price will fall. That's why the polluters are so happy with Rudd's decision to move to a floating price a year ahead of schedule.

The polluters can't wait to pay the floating European price, currently about \$6 a tonne, rather than face another year of the fixed Australian price of about \$25.

Of course, it wasn't meant to be like this. The introduction of a carbon price was meant to drive major changes to the way that we generated and consumed energy. The forecast carbon price of \$25-\$30, we were told, would drive investment in energy efficiency and encourage consumers to switch their consumption patterns away from goods that generated lots of pollution and towards products with less embodied carbon.

Similarly, the forecast carbon price of \$25-\$30 was supposed to place our "emissions-intensive trade-exposed industries" under enormous pressure to compete. Instead we agreed to give them 94.5 per cent of their pollution permits for free, along with hundreds of millions of dollars in cash.

But, as we have seen this week, the forecasts for the carbon price, and the forecast economic destruction, were a huge exaggeration. Who could have imagined that the polluters would do such a thing?

The big miners and polluters have spent years telling us how expensive it would be to tackle climate change. Meanwhile the scientists urged governments around the world to cut emissions by up to 40 per cent by 2020; the big polluters persuaded us otherwise. Such ambition, we were told, would come at a crippling cost.

Emissions trading works on the idea that our politicians decide on the amount of pollution they are willing to allow. Having determined the level of pollution they deem to be safe, they then require companies that pollute to buy a permit for each unit of pollution they emit. For example, if Australia decided it wanted to allow a million tonnes of CO₂ emissions, it could issue a million permits to release a single tonne of pollution. A company that wants to emit 10 tonnes would need to buy 10 permits.

Once our politicians have determined the level of pollution they deem to be safe they have effectively determined the supply of pollution permits. With the supply of permits fixed, the price of those permits will then be determined by the demand from polluters. If there is a lot of demand for pollution permits relative to the supply, then, like prawns at Christmas time, the price will rise. And if there isn't much demand relative to the supply, then, like ski gear in summer, the price will fall.

The problem with the European and Australian emissions trading schemes is that when the politicians were determining the "safe" level of pollution they paid far more attention to the polluters than they did to the climate scientists.

Now that it has become clear just how exaggerated the polluters' fear campaign about the economic impact of tackling climate change was, the question is what, if anything, should be done about it?

The first and most obvious thing we should do is to abandon the idea we should be giving free pollution permits to the biggest polluters. The whole point of imposing a price on pollution is to make the polluter pay.

The second thing we should do is stop listening to the polluters and start listening to the scientists when it comes to setting the emissions-reduction targets. While the government has set up a Climate Change Authority to advise on future targets, it saw fit to appoint the chairman of an aluminium company and the former head of the Australian Industry Group to that body.

The third thing we could do is to give the polluters, consumers and the emerging renewable energy industries the "certainty" they all say they need by switching away from emissions trading and introducing a simple carbon tax. The market for pollution permits, like the market for all financial products, will also be highly volatile. It should be obvious by now that the polluters did not want emissions trading because of the stability of the prices it would generate, but because of the smallness of the prices it would generate.

And finally, Australians need to look at the huge expansion in coal exports that is under way and ask our leaders whether they are really committed to a global reduction in greenhouse gas emissions. Australia has a larger share of the world traded coal market than the Saudis have of

the world oil market. Our plans to double our coal exports will drive the price of coal, and in turn coal-fired electricity, lower at a time we pretend to be concerned about global warming. Under the current circumstances, the choice between the government's polluter-pays system, cheap as it is, and Tony Abbott's "pay the polluter scheme" is clear.

But success in tackling climate change is not about politics or economics, it's about science. The world's emissions are rising. Australia's 2020 targets are far more timid than the science says they need to be and we are planning to sell far more coal to the world in 10 years than we do today.

The fact that carbon prices are far lower than expected is good news. The question is, good news for who? Will low prices convince our politicians that we can afford to be far more ambitious in our efforts to tackle climate change? Or will they simply deliver windfall profits to the polluters who wrongly predicted how tough things would be?

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