A price is not much help if the world can call the tune
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Pricing carbon is essential to an Australian economy that is to become less carbon intensive over time. There are however some important aspects of the detailed policy approach that make the risks and the economic costs larger than they need to be. It follows many of the broad principles of the hybrid approach set out in *Climate Policy After Kyoto: A Blueprint for a Realistic Approach* published by Brookings in 2002. In this there is market trading of emission rights over many years, but in the short term there is a floor price and a ceiling price of carbon where the ceiling is set by a central bank of carbon. In the announced policy there is a fixed price from July 2012, and then from July 2015 there will be a market with a floor price and a ceiling price. The ceiling price is not explicit, but because foreign permit trading is allowed, the ceiling price will be the price in the global carbon market. The difference between the hybrid and the announced policy is the source and stability of the ceiling price. The government relies on a global market and the hybrid achieves this through an Australian central bank of carbon transparently setting that price. This matters in a risky world. A long-term carbon price is essential to encourage innovation.

Companies that will be making long-term investments in carbon-reducing technologies today do not have a better understanding of what the carbon price is expected to be in 2040 relative to what they expected yesterday. This can easily be rectified if emissions permits for the 2050 target of an 80 per cent reduction are distributed now and traded.

The result of the Treasury modelling is that more than half of Australia's emission reduction will be generated by allowing foreign permits into the Australian carbon trading market.

Abatement within Australia is estimated to generate less than one-half of the emissions reductions by 2020. Relying so much on foreign permit purchases has both an environmental risk (the permits may not actually reduce emissions in countries we buy from) and an economic risk in that the large volume of permits flowing in could destabilise the local price if any major international climate market becomes unstable. This is not hypothetical, given the collapse and volatility of foreign carbon markets. It is not necessary to rely on foreign markets to cap the costs. The hybrid approach allows a less risky way of achieving this outcome.

A further issue is the amount of revenue churning in the policy. Free permits could have been given directly to Australian citizens that they could then sell to industry. The more revenue that is churned through the budget, the greater the political benefit to the government but also the greater the cost to the Australian economy. The fact that only 60 per cent of emissions are covered increases the administrative costs of the policy and raises the costs incurred in reducing emission from other activities.

Some clever use of revenue such as changing the tax-free threshold is a very positive aspect of a policy that clearly had more than just climate change in its sights.

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