

Simple plan to beat pollution

Tim Hughes
ECONOMICS

A FEW days ago I had to talk to a business audience about the investment opportunities presented by climate change. The more I thought about it, the more I realised the total folly of the Federal Government's approach.

Denial aside, the approach has been piecemeal, fragmented and has made no real attempt to rely on the basic economics of the market.

For a Government so committed to economic rationality, it appears to have terrible trouble leaving it to the market when it comes to dealing with the need to cut carbon dioxide emissions.

What we really need is a comprehensive cap and trade system that

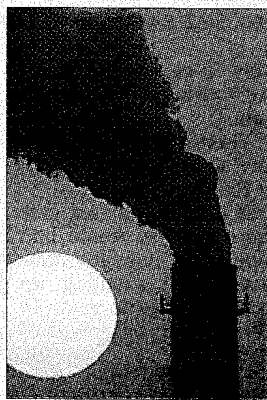
efficiently puts a price on carbon emissions.

This is a system where we decide how much carbon dioxide we are prepared to emit each year, issue permits for those emissions — but no more — and allow permit holders to trade permits, effectively setting a market price for carbon emissions.

Not only will we reduce our carbon emissions to the desired level, but the market will decide the most efficient way to do it.

By pricing carbon and allowing permits to be traded, those electricity generating methods that produce the most carbon dioxide per megawatt hour will see their costs rise sharply as they will have to buy permits.

Those that produce the least will be able to sell their permits and use the



CLIMATE change threat ... market must decide.

proceeds to offset their higher costs.

It has to be a broad-based scheme without special deals. The problem here is that the devil of emissions trading is very much in the detail and that will depend critically on who drafts the

policy. So who does the commonwealth put on its taskforce to advise on a carbon emissions trading system? The big miners and polluters.

As former Reserve Bank deputy governor Stephen Grenville wrote this week: just giving permits to the worst polluters, as business wants, is not the answer.

While the pricing mechanism is the best way we have to efficiently ration and allocate scarce resources, in this case the right to pollute our atmosphere, it will mean higher prices for energy, particularly electricity.

Consumers have too great an interest in how the new carbon trading system is designed to leave it up to the big polluters. Be warned!

Tim Hughes is a director of Value Capital Management
timvcm@bigpond.net.au