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SUBMISSION TO THE INQUIRY INTO THE REGULATORY ARRANGEMENTS FOR TRADING IN GREENHOUSE GAS EMISSIONS

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Summary

Whilst the initial driver for action regarding greenhouse gas (GHG) emissions is one of environmental risk management, at back of the international GHG negotiations are considerations of national comparative trade advantage.

As such, the EMIAAs see that a market in GHG emissions must be developed as an integrated component of a nationally coordinated effort to maximise Australia's competitiveness.

The regulatory arrangements must be structured to:

1. rapidly secure low cost certified emission reductions for use in Australia
2. promote baseline shifting developments in Australia
3. promote commercially viable energy efficiency and low emission measures
4. establish primary and secondary markets of good liquidity and integrity
5. mesh in with emerging international markets in GHG emissions and credits
6. minimise the compliance costs for both Government and industry

These requisites and the commodity nature of GHG emission permits and credits share many similarities to the financial and securities sectors. Thus in designing a regulatory regime to facilitate the trading in GHG emissions, the Acts and other mechanisms that underpin the operations of the Reserve Bank of Australia (RBA), the Australian Securities Commission (ASC) and the Australian Stock Exchange (ASX)and Sydney Futures Exchange (SFE) serve as good starting models.

The EMIAA recommends that a body equivalent to the RBA be established to have national responsibility for the quantification, allocation and utilisation of emission permits and credits. For the purposes of this submission, this body is referred to as the Emissions Trading Authority (ETA).

In a manner similar to the functions of the RBA, the ETA would perform both supervisory and intermediary roles. Ensuring prudential requirements are met and also taking market positions to manage the overall national obligations, liquidity and market confidence needs.

In a manner similar to the ASC, the ETA would also regulate the issue and trading of emission permits and credits, the registration of auditors and the licencing of advisers and dealers. It would also promote market integrity via education, surveillance and enforcement activities.

Below the Emission Trading Authority which is the prime regulator, a private sector, self regulating body equivalent to the ASX or SFE would operate via a system of co-regulation. For the purposes of this submission, this body is referred to as the Australian Emissions Exchange (AEE). It is at this level, in the private sector, that the majority of market activity would occur.

Again, the objective in implementing this system is to establish a means by which Australia can most cost effectively meet its international GHG emission obligations.

The system must not be an unwieldy and onerous bureaucratic burden for either the Government regulatory entities or for industry. Australia must remain cost competitive in international trade.

EMIAA believe there are many avenues for cost effective emission reduction and credit generation that can be utilised by industry to proactively manage its obligations. The onus is on the Federal Government to take a firm leadership role in coordinating the various components of a national strategy to protect Australia's national interests.

The International Context

The underlying global climate change risk management imperative has been stated by many world leaders and has been documented in the United Nations Framework Convention on Climate Change (UNFCCC) adopted in May 1992 and in subsequent protocols.

However, whilst the long term risk of climate change is the fundamental driver for international action, the commitments documented in the Kyoto Protocol to the UNFCCC, December 1997 and to be ratified during 1998 represent a significant process of international positioning where all countries are focussing on protecting and enhancing their short, medium and long term international trade competitiveness.

Australia achieved close to the most lenient quantified emission limitation and relative concessions relating to the inclusion of land clearing activities in baseline and emission assessments. However, there remains a real possibility that the finally adopted land clearing auditing parameters will not suit Australia's needs and the international achievement of these positions is only the first step in a process that will continue through to the establishment of a legally enforceable international regime. Currently planned in the Kyoto Protocol to commence in 2008.

Australia's lobbying and the position it achieved in the Kyoto Protocol has led to Australia being exposed to an inordinate degree of international scrutiny. This fact, and the fact that other countries are committing significant effort to achieving competitive positions from the establishment of the emerging regime, dictates that Australia must maintain a capable, extensive, active and effective participation in the international negotiations process to ensure the regime that is ultimately implemented is beneficial to Australia's interests.

More fundamentally, Australia must proactively structure its domestic and international operations to minimise cost impacts and maximise trade competitiveness within the emerging regime. It is within this overall context that trading in GHG emissions must be considered.

The Kyoto Protocol established the preliminary framework for two major international initiatives that must be fully understood and utilised by Australia to both minimise the cost of GHG abatement and to present business development opportunities for Australian industry.

These initiatives are Baseline Shifting, Article 3 of the Kyoto Protocol and The Clean Development Mechanism, Article 12 of the Kyoto Protocol. Australia must act decisively and quickly to achieve benefit from these initiatives ahead of other Annex 1 and non annex 1 countries.

An Integrated Component of a Nationally Coordinated Effort

It is highly desirable that a GHG Emission Trading Regime be developed as an integrated component of a nationally coordinated effort to maximise Australia's competitive advantage.

The major components should include:

1. Initiatives to promote commercially viable energy efficiency and low emission measures
2. Measures to rapidly secure low cost certified emission reductions for use within Australia
3. Measures to promote Baseline Shifting Developments in Australia

In this context, an emission cap and trading regime which includes trade in certified emission reductions becomes both the driver and facilitator of the above components.

The Participants

Participants in the GHG emission permit and credit trading regime would include:

The Australian Federal Government	Responsible for the overall national commitments made under the UNFCCC process.
	Responsible for ensuring Australia is best positioned for international competitive advantage.
Existing Industry Operators	Motivated by minimisation of cost, effort and impact on core business
New Industry Operators	Must not be restrained from market entry by an emissions hurdle not imposed on existing market participants
Generators of Emission Credits	Motivated by revenue streams available from trade in emission credits
Intermediaries and Dealers	The critical link between owners of emission permits and credits and those seeking to utilise permits and credits
	Entities prepared to stand in the market to buy and sell emission permits and credits
Service Providers	The entities who supply professional and technical services to the market. Including auditors, certifiers and process improvement advisers etc.

In comparing the above to the nature and structure of the Australian financial and securities sectors, there are many similarities in the parties, their responsibilities and motivations.

For this reason, EMIAA recommends that a regulatory regime be developed that uses the Acts and other mechanisms that underpin the financial and securities sectors as starting models.

A Performance Specification

The Domestic Emission Trading regime:

must be compatible with international regimes	Australian entities must have the ability to trade internationally. Whilst the overall national position is monitored and restrained within national emission limit commitments
must include all sources and sinks included in the national inventory and covered under the Kyoto Protocol	A phased implementation equivalent to the process adopted in establishing a contestable market for electricity supply is appropriate. Whereby allocation of caps commences on a sector by sector basis and is initially applied to large scale participants and subsequently applied to smaller scale participants over a number of phases.
must be sufficiently in place by 2000 to support domestic and international development of emission avoidance and sequestration projects in accordance with the Article 12.10 of the Kyoto Protocol	Article 12.10 permits CER's obtained from the year 2000 to be applied towards achieving compliance in the first commitment period. This effectively permits industry to acquire eight years of CER's prior to the 2008 start of legally binding compliance. This accrued pool may them be drawn down over subsequent years to minimise the impact of compliance. CER's utilised in this fashion may permit industry to postpone major capital expenditure in emission reduction activities until post 2012. A period of time likely to be well beyond the standard replacement cycles of capital equipment already committed. Permitting a further 10 plus years of efficiency and emission reduction technology development to occur prior to new commitment.
must be structured and regulated to maximise certainty and reduce transaction risk and cost.	Several models are available for application in designing an appropriate structure and regulatory environment. These are discussed in the following section. The details must be established and communicated to industry with maximum forward notice, say > 18 months, and must be established with say a 10 year outlook with say 5 yearly reviews. This permits adequate forward planning by industry.

A Regulatory Structure That Maximises Certainty and Reduces Transaction Risk and Cost

There are many analogies between the needs for an efficient GHG emission permit and credit trading regime and those of the financial and securities sectors.

These sectors are essentially regulated via two entities, the Reserve Bank of Australia (RBA) and the Australian Securities Commission (ASC).

The EMIAA recommends that an entity be established that applies overall control, regulatory and intermediary functions to the GHG emission permit and credit trading activities in a manner equivalent to the functions of the RBA and ASC.

For the purposes of this submission, this entity is referred to as the Emissions Trading Authority (ETA).

The RBA is an intermediary in the sense that it acts as banker and financial agent for the Commonwealth Government and provides banking services to some State and Territory Governments. However, the primary role of the RBA is one of regulation. As a central bank, the RBA oversees the activities of Australia's financial markets.

In a similar manner, the ETA would have peak responsibility for the quantification, allocation and utilisation of emission permits and credits. At the highest level, this means ensuring Australia meets its internationally committed GHG emission limitations.

Below this level, the ETA would be responsible for allocation of initial emission permits to current industry participants. Whilst retaining pools of emission permits for allocation to new industry participants and for use in risk management and underwriting market trades.

It is proposed that the allocation process be rolled out on an industry by industry basis in a manner equivalent to the contestable market for electricity. Whereby, allocation occurs to largest operators first and is rolled down to successively smaller operators over a several year period.

The RBA uses market operations to control the amount of funds in the financial system so as to influence interest rates with the ultimate aim of controlling inflation, economic activity and unemployment. In a similar fashion, the ETA may take domestic and international market positions to cover Australia's national obligations and to influence local market liquidity and confidence conditions.

The ASC regulates the issue and trading of securities, the registration of auditors and the licencing of advisors and dealers. It also promotes market integrity via. education, surveillance programs and enforcement activities. Likewise, the ETA would set the prudential guidelines and control the activities of participants active in all aspects of the quantification, application, auditing and trade in GHG emissions, emission permits and credits.

Trade in emission permits and credits need not be limited to government entities. Private sector, entities under the regulation of the ETA may take these roles.

The Australian Stock Exchange (ASX) (and the Sydney Futures Exchange) serve as a good model.

One of the objectives of the ASX is to facilitate an internationally competitive, fair and well informed market for securities. It also sets the financial requirements and standards of behaviour for members of the ASX (ie the stockbrokers). Stockbrokers are governed by the ASX's Business Rules which specify operating standards in such matters as accounts, sudits, client relations, trading and delivery and settlements. Such a private sector entity, operating via a system of co-regulation with the ETA would provide the market depth, breath and transaction systems necessary to minimise the risks and costs of GHG emission permit and credit trading.

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