



# **HOUSE OF REPRESENTATIVES**

**STANDING COMMITTEE ON ENVIRONMENT, RECREATION AND THE ARTS**

**Reference: Trading in greenhouse gas emissions**

**CANBERRA**

**Thursday, 2 July 1998**

**OFFICIAL HANSARD REPORT**

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HOUSE OF REPRESENTATIVES  
STANDING COMMITTEE ON THE ENVIRONMENT,  
RECREATION AND THE ARTS

Members

Mr Causley (Chair)

Mr Jenkins (Deputy Chair)

Mr Anthony	Miss Jackie Kelly
Mr Billson	Mr Kerr
Mr Robert Brown	Dr Lawrence
Mr Eoin Cameron	Mr McDougall
Mr Entsch	Mr Mossfield
Mr Hockey	Dr Southcott

The committee will inquire into the regulatory arrangements that would need to be put in place to support a market in greenhouse gas emissions including:

mechanisms for measuring, verifying and monitoring emissions and the compliance with contracted arrangements;

mechanisms to integrate emissions trading with the development of carbon sinks (such as timber plantations, gas aquifer reinjection, soil rehabilitation etc), including the science, measurement and security of such arrangements;

the allocation of the right to emit greenhouse gases;

regulatory mechanisms to support a national market and potentially an international market in emissions trading;

possible emission traders, administration and transaction costs;

roles and responsibilities of governments and other stakeholders; and

the impact of emission trading on the environment and industry and the economic and social welfare of the Australian community.

**WITNESSES**

**JONES, Mr Barry Richard, Executive Director, Australian Petroleum  
Production and Exploration Association, Level 3, 24 Marcus Clarke  
Street, Canberra, Australian Capital Territory 2600 . . . . . 557**

HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON ENVIRONMENT,  
RECREATION AND THE ARTS

*Trading in greenhouse gas emissions*

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Present

Mr Causley (Chair)

Mr Anthony

Mr Kerr

Mr Billson

Dr Lawrence

Miss Jackie Kelly

Mr Mossfield

Committee met at 9.14 a.m.

Mr Causley took the chair.

**CHAIR**—I declare open this public hearing of the House of Representatives Standing Committee on Environment, Recreation and the Arts for its inquiry into the regulatory arrangements for trading in greenhouse gas emissions. This is the committee's ninth public hearing for this inquiry. It follows hearings in Sydney, Brisbane and Melbourne. One more hearing is planned after this in Perth.

The committee's inquiry is focusing on the arrangements that should be put in place for a trading scheme in greenhouse gas emissions in Australia. As we collect information about the best scheme to adopt, we will be looking for mechanisms that will ensure emission trading contributes to a emission reduction as equitably, effectively and efficiently as possible. We will be looking for ways of providing maximum certainty at minimum cost for the environment and the emission traders.

Before proceeding, I advise the witness that the committee's public hearing is recognised as a proceedings of the parliament and it warrants the same respect that proceedings in the House of Representatives demand. Witnesses are protected by parliamentary privilege in respect of the evidence they give before the committee. You will not be asked to take an oath or an affirmation. However, you are reminded that false evidence given to a parliamentary committee may be regarded as a contempt of parliament. The committee prefers that all evidence be given in public but, should you at any stage wish to give evidence in private, you may ask to do so and the committee will give consideration to your request.

I call the representative of the Australian Petroleum Production and Exploration Association.

[9.16 a.m]

**JONES, Mr Barry Richard, Executive Director, Australian Petroleum Production and Exploration Association, Level 3, 24 Marcus Clarke Street, Canberra, Australian Capital Territory 2600**

**CHAIR**—Welcome. We have received a submission from you and have authorised its publication. Do you propose any changes at this stage to your submission?

**Mr Jones**—No.

**CHAIR**—Would you like to make a brief opening statement?

**Mr Jones**—Thank you. The issue of the design, timing and implementation of emission permit trading is of prime importance for APPEA members for both domestic and international trade reasons. APPEA has three broad concerns about public discussion of emission trading. Firstly, there seems to be a presumption that emission trading itself will actually reduce emissions. In our view, that is not the case. Emission trading is merely a least-cost mechanism of achieving emission reductions. What you need to back it up is a comprehensive suite of policies and measures designed to reduce emissions, to enhance sinks and to address adaptation to change.

Secondly, it needs to be understood that emission permit trading, as it stands at the present, is only a textbook concept. There is a wide gap, both domestically and internationally, between the theoretical model and the realities that will face the practical operation of the permit trading system. Thirdly, we wonder why—given the uncertainties that prevail in the international system in particular—some people are rushing to judgment and trying to trade at this stage.

The world seems to us to be considering two broad approaches to emission permit trading. For convenience, I will call one the commodity cartel approach and the other the stock market approach. The essential characteristic of the commodity cartel approach, as we see it, is government to government trading internationally and a government managed command and control system domestically. In APPEA's view, such an approach is unacceptable and doomed to failure.

We feel, firstly, that it will fail for the same reasons that all other attempts at regulated commodity trading—zinc, coffee and oil—have failed in the past. Like all command and control mechanisms, it will be bureaucratically cumbersome, costly to administer, operationally intrusive, inflexible and unresponsive to change. In short, it will be inefficient, inequitable and not meet two of the criteria which you have just spelt out, Mr Chairman.

Secondly, in an international context, we feel that it will fail because the

fundamental deficiencies of the Kyoto Protocol mean that government to government trading can never be a least-cost mechanism. The inherent flaws of the Kyoto Protocol, the limiting of emission permit trading to Annex 1 countries and the acceptance of the European bubble inevitably mean that the commodity trading model will fail internationally. It will be a monopolistic market dominated by a few large buyers and sellers, where the rest of the participants, including Australia, face a price taker situation. It will mean inflated prices, higher than necessary costs, a loss of competitiveness, a decline in economic wellbeing and, in our view, a less than optimal environmental outcome.

In the stock market model, the role of the government would be limited. Internationally, the role of the government would be purely one of reporting. It would take data from market trades, report it to an international authority and report the implications for Australia's national target set in the Kyoto context. Domestically, the government's role would be limited to the passage of framework legislation. The market would determine the trading mechanisms, the trading terms, and monitoring and verification systems. The great benefit of such a model is that, internationally, it maximises the level of competition in the market and therefore minimises the capacity for monopoly activities, price distortion and trade cost; domestically, it maximises flexibility and adaptability, and minimises transactions cost.

I want to look in detail but briefly at what such a marketplace model might look like. We think there are four basic design parameters. Parameter 1 is that the scheme should not operate to undermine the international competitiveness of the Australian economy. It must not introduce trade distortion between participating countries or between participating and non-participating countries.

The key operational element that flows from the competitiveness parameter is that the initial allocation of permits must be on a free of charge basis. They should not be auctioned. To conduct an auction in the Australian context would place Australian industry at a significant cost disadvantage, both against companies in other Annex 1 countries and against those in non-Annex 1 countries.

The other operational element that flows from the competitiveness parameter is that the permit trading system must be dovetailed, domestically and internationally, with the other so-called flexibility mechanisms, joint implementation and the clean development mechanism. If there is to be any chance of minimising the anti-competitive effects of the Kyoto Protocol, there must be a dovetailing. That maximises the possibility of trade and competition.

Parameter 2 is that the framework legislation needs to be designed on a minimalist intervention approach. The main areas to be addressed in the framework legislation should relate to the setting of the preconditions for trade and, in particular, the two difficult issues: the coverage of the scheme and the initial allocation of permits. Both of these

issues I will return to in a few moments.

The base model should be the current stock exchange system and company law. We do not need to specify the verification mechanisms, the trading mechanisms, the auditing mechanisms, et cetera. These can be determined by the market. The essential thing is that normal processes of due care and diligence must apply.

Well-managed permits and credits—that is, those where there is an identifiable and verifiable emission baseline and where changes in emission levels are backed by credible documentation—will be more in demand and given a higher price in the market than those which I would loosely call shonky. Unfair or fraudulent trading should be subject to penalties.

Government determination of measurement mechanisms is not essential. The only precondition in this regard is that the measurement mechanisms must conform with the provisions of the climate change convention. In this regard, a key prerequisite is going to be international agreement being reached on the measurement of sinks and carbon absorption, and this has to be done quickly. If it is not, it limits the capacity for credits.

Permits and credits must have legal backing. They will be a valuable negotiable instrument and they will be a property right. The principles of common law and legislative law that apply to the valuation of assets and compensation for confiscation must apply to credits and permits. The companies should be able to bank permits just as they can bank cash. Trading should not be compulsory. However, the system should provide an economic incentive for those who can take cost-effective abatement action to actually do so. If companies bank permits or credits, they have to recognise that they are taking a risk. If the market conditions change, if a new technology comes along that makes emission abatement easier or less costly, a glut of permits is likely to arise, the price will fall and the value of the bank permits would be less.

The third parameter we would set is that the coverage of the scheme must be national. In our view, state based schemes would be inefficient, inequitable and potentially unconstitutional, and would undermine the competitive domestic energy market.

The fourth parameter is that the scheme must be open. That is, it is essential that the national market scheme be linked with the international scheme. If an Australian trader of permits wishes to sell in the United States, because they can get a higher value in the United States market than in the Australian market, they should be able to do so. We have to recognise that there will be leakages, both of permits and of credits, from the domestic system. To try to stop these leakages would, in our view, be unacceptable and an impediment to trade.

I wish now to return briefly to the two most difficult and most critical issues: the coverage of the emission permit trading system and the matter of the allocation of permits



initially. In relation to coverage, the first requirement is that trading cover all gases and all sinks. The second requirement is that all sources of emissions should be covered, either directly or indirectly. If coverage is indirect, then there must be no barrier to passing on costs to the final emitter. Failure to have comprehensive coverage in all sources will create inequities and inefficiencies. If a market mechanism cannot be designed to cover all sources and all sectors, then other price based policies will have to be considered and introduced by government at the same time as trading commences. Freeloading is unacceptable.

The issue of coverage is one area where APPEA strongly believes that this committee should recommend that further work should be done. In some areas—government, the electricity trading system, manufacturing, banking, retailing—it is easy to measure emissions, it is easy to see how such a system would work. We think that, with a little bit of adequate public education, small business could be covered. With a degree of ingenuity, we think, agriculture and land clearance emissions could also be covered. However, some more work needs to be done here.

To our way of thinking, the difficult areas are private transport and the residential sector. I think the gut reaction of anyone when they first look at these two sectors is to say, 'It is all too hard. We have to exclude them.' We do not think that it has been thought through. We do not think that adequate consideration has been given. Basically, if you and I can trade AMP shares on a stock market, why can't we trade credits or emission permits on a stock market? APPEA thinks that governments should commission some serious work in regard to this area. After all, 14 per cent of emissions come from these two sources.

The other area where APPEA considers a considerable amount of work remains to be done is the base allocation of permits. Here we think two issues are absolutely essential. The first is: what is the base share? That is a matter which needs detailed consideration. The other is: how are new projects and natural growth in the number of households and private vehicles to be handled?

The APPEA submission addresses some of these issues in a greater degree of detail. I will not revisit them here. I would like to thank the committee for their attention.

**CHAIR**—Thank you. I would have to say that that is different evidence from what we have received from others, but nevertheless interesting. It seems to me that you are fairly negative on a trading scheme at this particular time. Do you have any ideas of how Australia might meet its Kyoto Protocol?

**Mr Jones**—The first thing we need to recognise about the target is that, depending on how the flexibility mechanisms work, it is plus or minus eight per cent. It is not eight per cent. Secondly, there is a huge amount of evidence that there is a large number of no regrets options that have never been tapped effectively: the efficiency of power stations,

the efficiency of pumps, the efficiency of small electric motors, the efficiency of motor vehicles, the urban design system—you can go on and on and on. I do not suggest that tackling those things is easy. There is a degree of political will that is required at all levels of government and there is a degree of public education that needs to go on. But those things, if tackled, can take us a huge way towards the target and they should be the first things we take on. Apart from anything else, there are very good economic and other environmental reasons why we should take them on. We would see those things as being win-win.

**CHAIR**—Your industry is probably one of the bigger emitters. Do you know what percentage it might constitute at this stage?

**Mr Jones**—I would contradict you and say that we think we are one of the smaller emitters. Depending on how you define our industry, we would say a maximum of five per cent of national emissions.

**Dr LAWRENCE**—What is that definition?

**Mr Jones**—It depends on whether you include the refinery sector or you do not. My organisation's ambit is from the ground, the wellhead, to the refinery flange, and then the Australian Institute of Petroleum covers the refinery sector. It is five per cent if you take from the flange to the wellhead; it goes out to about 6½ per cent if you include the refineries. Chairman, when you make the comment about being a large emitter, it then raises the question of whether we are responsible for what happens in a gas-fired power station or oil in a plant, oil in a car, oil in domestic heating and gas—

**CHAIR**—I was looking at the product, I suppose. My question was probably looking at the product.

**Mr Jones**—There is absolutely no doubt that the transformation and the use of energy by any measurement is the largest source in the country.

**Dr LAWRENCE**—So in a sense what you are arguing—sorry Mr Chairman, if you do not mind my just following this through—is that you should be responsible, whether it is in a market framework or any other, for only that emission which attaches to the course of production of the product, and the end users, whether it is through a power station or a motor vehicle or whatever, should then be responsible and therefore able to trade.

**Mr Jones**—The only thing I have control over or my members have control over is that which is within their commercial activity, which is that first part of the system.

**Dr LAWRENCE**—I understand what you are saying.

**Mr Jones**—Put another way, if you do not want gas heating or gas cooking, we will not sell gas. What we produce only has a value because of its use in cars, in households, in factories and in electricity generation.

**CHAIR**—There has been some interesting evidence about who, if we went into a trading system, would buy the permits; and in this particular industry, the vehicle industry, there have been all sorts of suggestions as to whether your particular industry should buy the permits or in fact the manufacturers of vehicles should buy the permits. Do you have any opinions on that?

**Mr Jones**—Only to say that there are large winners or losers depending on where you do it.

**CHAIR**—Could I put it to you this way: it may have been my opinion or it may have been put by someone else that if you are talking about incentives to get people to change their habits, then maybe manufacturers should buy the permits because they can look at alternative technology. You have no incentives to do that. You are trying to sell a product.

**Mr Jones**—We have two incentives. One is that energy is a cost of production to us just like it is to anyone else. We are in an internationally competitive market, getting somewhere between \$US13 and \$US11 a barrel for oil. It is a commodity that is at the bottom of the cycle, like most other commodities in this country at present. Anything we can do to cut costs, we will do. Therefore energy efficiency within our operations is a fundamental driver at any time, and being exposed to an international market, which we have been since day one of the industry, both on the LNG and on the oil side, has a huge driving force behind that.

Secondly, good environmental management says you address the issue as well. We are proud of our environmental record and we consider we ought to be good corporate citizens, therefore we address the issue.

**CHAIR**—Am I correct in saying that you are very sceptical of a trading scheme at the present time? The very fact that this was included in the Kyoto Protocol—does that not indicate to you that there are other people in the world who are keen to get involved in a trading scheme?

**Mr Jones**—I am sceptical. My view would be that Australia, as it has been in the climate change debate right since day one, is way in advance of most other countries in understanding the implications of what is being talked about. I would be surprised if Ambassador McDonald has not made comments to you along the lines that her view is that Australia is way in advance of certainly the Europeans and most of the Pacific Rim Annex 1 countries in their understanding of what emission permit trading is, how it might work, what the difficulties of it are, what the practicalities of it are, et cetera. It is that

understanding of this fact that it is not simple that makes us sound a little bit sceptical.

**CHAIR**—You mentioned in your opening statement about Annex 1 countries and non-Annex 1 countries. There has been evidence before the committee on that particular issue as well. I seem to believe that this is all tied up in the clean development mechanism and that companies, particularly the types of companies that you people represent, have the ability to put technology in place in non-Annex 1 countries that could improve their emissions and get credits for it. Would your companies be looking at that?

**Mr Jones**—My sweeping generalisation in answer to your generalisation is yes. If I could go back a couple of stages, you have to segment the industry to get a more accurate answer. In terms of oil production, which is roughly 50 per cent by volume of what the industry produces, the answer is no, there are no alternative technologies that you can put in place in other countries. Oil is a commodity which is sold in the international market. It goes into refineries which are at a predetermined location and it then goes off into other uses. On the oil side, I think there are very limited opportunities.

With regard to LNG, in theory there are huge gains for Australia, both in the clean development mechanism and joint implementation, because the mathematics of LNG usage are that in Japan or in Korea an LNG power station would save the Japanese or the Koreans 1½ or maybe even as much as 2½ times the total amount of emissions which the extraction of gas and the production of LNG would produce in Australia. There is definitely a global gain from using LNG and there is potentially a trade situation which you can set up where some of that benefit is brought back into Australia and is used to help to meet Australia's target.

The third part of the answer to your question is that, at least in the upper end of my industry, most of the large member companies of APPEA are not oil companies; they are energy companies. They are engaged in all forms of energy production. Companies like Shell, BP and Exxon are all in the renewable energy game in one form or the other. The answer to your question is therefore, yes.

**CHAIR**—There could be some lateral thinking about getting involved in some of these technologies that would give you credits if a scheme came into place.

**Mr Jones**—Yes, undoubtedly.

**CHAIR**—Graham McDougall, who is not here, asked this question on several occasions to other people and I am sure he would ask it again. BP, in particular, have been fairly well publicised in the fact that they are trying, within their international company set-up, to trade or reduce emissions—I think it is probably on the environmental area where they are certainly setting out to do this. There is a little bit of scepticism that these international companies could use a non-annexure 1 country to, in fact, improve their position in annexure 1 countries. Do you see that as being a problem?

**Mr Jones**—I will start with the baseline statement. Greenhouse is a global problem; it requires a global solution. As I am sure other people have said to you, if not formally, informally, if you stop the OECD producing CO<sub>2</sub> now, instantaneously, it would have no effect on what is going to happen in the climate change in the atmosphere for another 50 or 100 years and, in any case, it would have minimal impact on what is going to happen, given growth in the developing world, et cetera.

If we are going to deal with this thing in any sort of a sensible way, either economically or environmentally, then somehow or the other the developing countries are going to have to be involved in the exercise. That means that if large corporations trade internally within themselves, so be it. That is one way of doing it. If that means that we get an effective clean development mechanism up that covers sinks, new technologies and existing technologies and you manage to get offsets or if you get an equivalent of joint implementation which enables you to do that, or if you get countries like Korea, Mexico, Argentina and Brazil signing on to Annex B or Annex C of the Kyoto Protocol and making notional commitments to doing things, then all of those things are going to be essential to make the system work.

**Dr LAWRENCE**—I do not think anyone is suggesting that this is the only solution, by the way, but it is just one that we happen to be looking at and we are very keen to make sure we get the views of all sectors of the community. One of the things that I was interested in, and I think you reiterated it again today, was your view that if such a trading system is to develop, the permit should be seen as a property right and then available for compensation.

If there is a target for reduction which is known in advance, and if, for instance, the permits are issued initially on a no cost basis—which is a suggestion that many have made—and you understand that those permits have a reducing value over time of, say, two per cent or one per cent or whatever it may be, do you still see that compensation would be justified in those circumstances, if that is the basis on which it is initially applied?

**Mr Jones**—I am not sure that a permit does decrease in value over time. It depends on the nature of the permit and the industry and things like that.

**Dr LAWRENCE**—That is one of possibility that has been suggested to us.

**CHAIR**—What we are talking about is that, if you want to reduce your levels of emissions, any permit would be probably reduced over time by a percentage every year to try to reduce your emissions. Is that what you were getting at?

**Dr LAWRENCE**—That is one model that people talked about.

**Mr Jones**—Let me come at it another way and then I will come back to that. If you were going to buy and sell these things in a market, then they must be a property

right. There is no other way. Our legal system does not have any other way of treating them. Therefore, when I talk about compensation, it is basically if fundamental ground rules are changed along the way.

**Dr LAWRENCE**—I appreciate that.

**Mr Jones**—We need to be a little careful about what you call the fundamental ground rules. We have a set of fundamental ground rules which take us from now to 2012. We have the first budget period. I do not think you can call a change in the rules of the game internationally post-2012 a force majeure government compensation exercise.

**Dr LAWRENCE**—Otherwise, governments would run a million miles.

**Mr Jones**—Anyone who is going into this game has to know that post-2012 the rules are going to be different to pre-2012 and buyer beware. You start monitoring the negotiations when they start in 2002 and 2005 and you take your appropriate positions on that. You hedge, et cetera. That is what commercial activity is all about. I cannot guarantee tomorrow that some scientist in the United States is not going to stand up and say, 'Water into energy is now possible and it can be done at 2c a litre. Oil is now redundant.' Theoretically that is possible. There is always uncertainty in the market. When we talk about compensation, we are talking about unilateral changes of the rules which are not related to the international negotiating process.

What about in terms of: does a permit diminish in value? Everything depends on how you allocate it. If you are going to allocate it on a plant by plant basis and all the accounting is going to be on a plant by plant basis, then yes, you are probably right. The economics would say that is the case. If you allocate it on a company by company basis, then the fact that the company is doing something in plant A does not mean that they have not put it in the new plant B. Whether their emissions are growing or declining depends on what the scale of their economic activity is at any time. It does not necessarily mean they are a bad environmental performer. It is to do with what the level of their economic activity is. Therefore, from a corporate point of view, it does not necessarily mean that the value of the permits or the number of permits is declining over time. It all depends on how you do it.

**Dr LAWRENCE**—In your view, what would be the preferable mechanism? That is what we are trying to get at.

**Mr Jones**—At the end of the day, it will have to be on a company by company basis at an absolute minimum.

**Dr LAWRENCE**—How then do you transfer that principle to these other uses that you talked about: households, private motor vehicle use, et cetera?

**Mr Jones**—That is where we need to think through a little more what we are talking about. I am hesitating because we have never formally discussed this within APPEA. Let me put it to you this way: in the past we have had all sorts of innovative schemes about how you can run motor vehicle registration to reflect the degree of pollution and road usage which a motor vehicle causes. Ten years ago those schemes were in the realm of fancy, both economically and technologically.

**CHAIR**—Why registration? Why not the manufacturer?

**Mr Jones**—I am just taking an example. There is any one of a number of ways you can do it. It used to be fanciful to say that you could put an electronic ring around central Sydney and every car in Sydney had a black box on it. When they went inside the ring the black box would trigger and at the end of the year you would read the emissions or the amount of time driven in the central city of Sydney and the registration fee would be set accordingly. We are now talking in some parts of the world about having freeways which have electronic triggers in them. As the car goes past on the freeway it triggers. At the end of the year you pay a bill, depending on your electronic trigger. Therefore, theoretically, the registration scheme can be changed.

**Dr LAWRENCE**—A lot of incentive to walk.

**CHAIR**—It is on the harbour bridge already actually.

**Mr Jones**—So technology changes over time as things become practical and we have to think about it in those terms. We have all sorts of green energy schemes which are beginning to operate within electricity markets. There are all sorts of ways you can do it. We just need to think it through a little more carefully and not just have a knee-jerk reaction—there are 18 million consumers out there; it is absolutely impossible; they are too small, et cetera. We need to be a little bit innovative about it.

**Dr LAWRENCE**—What you are suggesting is that there be some levers. You have mentioned the ring around Sydney. There is a very clear financial incentive then for users to be very careful about how often they get in the car and drive through. It is really government then, not so much the marketplace, that sets the rules?

**Mr Jones**—I would put it this way: there is an economic incentive. It is called retirement, et cetera, for which I buy and sell shares on the stock market. If I can drive my vehicle less or drive a more efficient vehicle and actually then create a credit which I can sell and earn myself income out of it, why shouldn't I? It should be no different from any other economic incentive that I face. How you do it requires a little more thinking along the way. At the end of the day it may prove to be impractical or it may prove to be impractical in stage 1 of the scheme. If we design a scheme that does not cover households and private vehicles initially, it should not be designed in such a way that, as time changes, you cannot bring them in later on. You should have other mechanisms that

go hand in hand while you do not have them within the trading scheme.

**Miss JACKIE KELLY**—I am just exploring this stock market idea a bit further. Are you suggesting something like a NASDAQ? Will it be a separate exchange?

**Mr Jones**—I think it will probably be a separate exchange. We have one beginning already: the Chicago Board of Trade is trading carbon. Theoretically, there is no reason why Sydney Futures Exchange or something like that could not start tomorrow.

**Miss JACKIE KELLY**—Is there some way the little Mum and Dad can get in on this—either purchasing a share or being allocated a share in the initial divvy up of our emissions?

**Mr Jones**—Since we are talking economic theory, the answer is: yes. In economic theory there is a way of allocating an emission permit to every household in the country. Theoretically, that is possible.

**Mr KERR**—Immensely impractical, presumably.

**CHAIR**—I would say so.

**Mr Jones**—Let me just make the point: we have just seen three huge stock market floats in which every household in the country was given the opportunity to buy. It was a hugely sophisticated operation for Telstra, for the Commonwealth Bank and for AMP, but it was done. Therefore, why can't we do it? The rule of the game that I spelled out in the opening statement is that you do not have to buy and sell permits. You do not have to buy and sell on the stock market either. In theory, and not necessarily in practice, it can be done. We just need to think about how you would go about doing it.

You may be right, Chairman. The more practical way to do it may be to do it on the white goods manufacturers, and on the motor vehicle manufacturers, and on the building designers, rather on the individual household. It may turn out to be much more practical to do it that way. Again, we have to understand the cost of doing that will feed through into the price.

**CHAIR**—There is a cost to everything.

**Mr Jones**—There will be a cost to it.

**Miss JACKIE KELLY**—That is what I was thinking. If you put the manufacturer of the car as the emitter, he has got to charge a through life cost for that. Some people turn over their vehicle or write it off within five years and others hang on to their vehicles 50 years.



**CHAIR**—But they might be given an incentive to develop an electric car or a steam car.

**Mr Jones**—Yes. The other thing is: is it necessarily a through life cost? If Holden has an initial allocation of permits and Holden can develop a more greenhouse efficient car than Ford, and they sell more Holdens and that gives them a pool of permits which they can sell, that may well feed back into a lower priced car eventually. It does not necessarily mean that you pay more in this exercise. Everything depends on how many permits you can sell and how the value of those permits are allocated back in the system.

**Mr KERR**—One of the points I was discussing earlier was that some people have said that the only practical way to do it is at the first point of consumption of carbon. If you put it on the manufacturer of the car, they cannot control the biggest input of carbon utilisation, which is the power station. Robots and the like are using power generated from Yallourn or somewhere. They do not have a mechanism of transferring or forcing the efficiencies upstream. They can only regulate the amount they use, so the most effective way is to put it on the first point of production.

The alternative view was they also have a lot of discretionary uses of carbon in their production processes. They do not have as much as they would draw down from the grid, but they still have a range of discretionary processes, so they should be able to have a separate and distinct permit allocation. But then the question is: how do you disaggregate out? How do you not have a cascading effect in relation to these issues? Have you thought that through?

**Mr Jones**—No. It is complex. Let me make some observations. If you get it put at the first point of consumption, one of the things you inevitably have to face is that there is going to be a large number of permits at those points. It may well be that, at the end of the day, there is a huge gain at those points also. If that is accepted within the rules of the game, right at the beginning, then so be it. But coming back to your compensation point, if 10 years into the system all of a sudden Western Power is making \$100 million or \$1 billion a year because they have had a huge first allocation of permits and they have made good business out of it, then you cannot say, 'Oops, we'll give up the tax system now and change the rules.'

**CHAIR**—No. I agree.

**Mr Jones**—You have to recognise that the economic logic says that the further back up the system you put the allocation of permits, the bigger the allocation of permits is eventually going to turn out to be, and the potential windfall gain—depending on how good you are at saving emissions—becomes significantly bigger. That has to be recognised and understood.

I notice that the national greenhouse strategy, when it finally sees the light of day,

will try to identify carbon from various sources. It is possible to do that in chemistry. Therefore, it should be possible, within a pooled electricity or gas system, or pooled coal supply system for that matter, to say, 'That fuel is more carbon effective than that fuel, therefore, I want to pay that, and I'm prepared to pay a premium to get it.' That will change the dimensions of the system over time.

You cannot think about this system as being rigid all the way along the way. Things will change and it is possible to put price incentives into it for the energy intensive manufacturing sector and for them to reflect back into the system. If Basslink is built, then the first preference will be that we all buy Tasmanian hydro in a permit trading system. That sends a signal.

**CHAIR**—You said in your opening remarks that you believe permits should be not auctioned but allocated. What flexibility does that leave? We give permits for the emissions we have at the present time, and given we may try to reduce those emissions over a period, why wouldn't you look at a system that said that so many permits would be allocated to the so-called polluters, the emitters, and so many would be auctioned, so many would be held back by government for new entrants?

**Mr Jones**—I think that, if you followed the SO<sub>2</sub> model in the United States, you would have to do that. You would have to do the mathematical equation. You would have to say, 'This was the business as usual line we projected to 2012; therefore, that sets the cap on the number of permits. The actual emission line is here now, so that is the number of permits we actually allocate to the market. The wedge in between is what we keep for growth into the future.' Let me make the point that it is not just growth in manufacturing in that period, it is population growth, and the outlook has to be built in as well. You have to do that sort of equation. There is no doubt about it at all.

I have two problems with auctioning of permits. Since you suggested to me that I was mildly cynical at times about this, let me be ultimately cynical. Given the way the system is at present, one of the largest emitters in the country via various means is government. If you have an auction system, is government going to be prepared to pay in the auction game and, if so, what is the budgetary cost of doing it?

**CHAIR**—Which area of government?

**Mr Jones**—I will say government collectively, but Commonwealth, state and local. At present we do not have a totally privatised electricity system. We do not have a totally privatised rail system. This building, I suspect, is one of the largest consumers of electricity in the ACT. In an auction system, would the Joint House Committee be out there paying for the permits for this building and, if so, how do you do it?

**CHAIR**—If you want my opinion, yes.

**Mr Jones**—I said I am cynical, and Duncan well knows that I have sat on the other side of the table and I have a great degree of cynicism on how the minister for finance or the Treasurer might react under those circumstances, no matter what the government or what level. That is one question. The fact that there is a large government sector in this needs to be considered.

The other thing is that there is a huge competitiveness exercise. One glib answer I will give you is that I have absolutely no problem with an auction system, providing the cost of buying permits for a commercial entity is 100 per cent rebate from company tax. In short, you use the auction system as the way of allocating, which is theoretically the perfect market, but there is no tax gain, there is no revenue gain to government from it, and there is no competitiveness cost to the company.

**CHAIR**—It is a business cost.

**Mr Jones**—Yes, and it is a rebatable business cost and not a deductible business cost. You get the whole lot back. There is no impact on your competitiveness. The market is used as a mechanism for allocating. In one sense, that is a dumb way of talking about it. It is processing money for the sake of it. If you are going to take the competitiveness side of the equation into account, then that is the sort of thing you have got to be talking about.

**Miss JACKIE KELLY**—If you are supposed to be reducing emissions and that permit is a property right and it is going to go up in value over time, when government tries to meet its targets which it is supposed to be getting down, we are going to have to buy that back off you.

**Mr Jones**—Why does government then have to buy it back off me?

**Miss JACKIE KELLY**—You are saying that it is a property right and you are seeking compensation for it.

**Mr Jones**—No.

**CHAIR**—Under the constitution, you were saying it is a property right.

**Mr Jones**—What I said is that if there is one of those lovely capricious actions that governments of all types are well-known for taking at times, and the rules of the game are changed during the budget period—

**Mr KERR**—You must be speaking of conservative governments.

**Mr Jones**—Mr Kerr, I was very careful with my choice of words. The normal commercial rules are that if government changes the law along the way and that affects

the value of property, then constitutionally at the federal level and by common law at the state and local level—

**Dr LAWRENCE**—And now by High Court decision.

**Mr Jones**—there is an obligation to pay just terms compensation. What I said before is that if the change of rules we are talking about is the change in budget period 2, budget period 3, budget period 4, to my way of thinking that is not a compensatable issue. If it is a change in the rules of the game of trading within a budget period which affects the value of the permit, then that should be compensatable.

**Mr KERR**—I have two practical questions. I came in late, so I apologise if you have been asked this before. One of the ideas that seems attractive to me is to issue a permit free of cost but to have a taper—the authorisation inherent in the permit to decline over a period of time—

**CHAIR**—Your colleague from Western Australia did raise that.

**Dr LAWRENCE**—It might not be the same question. We have touched on—

**Mr Jones**—Basically, my answer is the same. In economic theory, depending on how you have allocated your permits, the answer to that is yes. If you have done a plant by plant allocation then, in theory, yes, that is one way of doing it. If you have done a corporation by corporation allocation, it may not work in exactly the same way.

**Mr KERR**—But you still create a market and—

**Mr Jones**—You have still a market.

**Mr KERR**—It is the most efficient way of allocating what is a reducing—

**Mr Jones**—And I would still hold by my stock market analogy. If a company does not manage itself properly, then its profitability goes down, its attraction to shareholders goes down and the value of its shares goes down.

**Mr KERR**—Yes.

**Mr Jones**—And the same analogy should apply to an emissions trading system. If the companies operate properly, then they should be able to save their permits and do their trading before the decline in value or decline, however you want to work it, comes into effect.

**CHAIR**—Looking at what I said in my opening remarks about efficiently, equitably and cheaply trying to administer such a scheme, the measurement of emissions

and the enforcement of the control system, in your industry is it relatively easy to do that?

**Mr Jones**—We would believe that we measure it under our Greenhouse Challenge agreement which covers 95 per cent of the upstream oil and gas industry where we are effectively measuring the emissions now. The difficulty that we would have, like everyone else, is that the further back in time you have to go to try and retrospectively measure these things, the greater degree of subjectivity gets into the equation, given mergers and takeovers and all the rest of it.

The classic example is Santos. Santos bought a number of other oil and gas companies over the period from 1990 to now. Santos can measure its emissions very accurately now but whether it can actually trace them back through four or five different corporate structures to a 1990 situation and therefore do anything under them is a slightly subjective calculation. For a 1990 baseline, if that was the system that was chosen, there would have to be a degree of subjectivity for that calculation.

**CHAIR**—It raises that question. I think you mentioned in your opening remarks about when it started. Do you have firm opinions about, if a trading scheme is developed, when in fact it should start? Should there be grandfathering?

**Mr Jones**—Yes, there is. I said, ‘The two most difficult issues are . . .’ If we had worked through an answer to some of those questions I would have been expressing them to you.

**CHAIR**—Kyoto talks 1990. Do you think that that is reasonable?

**Mr Jones**—The only comment I will make about 1990 is the one I have just made. If you are going to use 1990, then there is going to be a high degree of subjectivity—

**Mr KERR**—It is the baseline for national emissions but it would be an absurd baseline for individual quota allocation, for exactly the reasons you give. Is that the proposition?

**Mr Jones**—I am not necessarily saying it is absurd. What I am saying is that there will have to be a degree of subjectivity entailed. You have all the problems. If you choose 1990, what do you do with the company that came into being in 1991?

**Mr KERR**—Precisely.

**Mr Jones**—What do you do with the company that went out of being in 1992? What do you do with the company that emerged in 1993? There really are some very difficult things.

**CHAIR**—Wouldn’t their liabilities and credits carry on to the new company?

**Mr Jones**—In theory, yes. But if the company went bankrupt in 1995 and it had a 1990 allocation of credits, who gets the credits? Does the liquidator sell the credits on the emissions market, get money for them and allocate it to the creditors? I guess, yes, that is one way of looking at it. Do they lapse back to the government? That is another way of looking at it. Those sorts of things need to be thought through, but they are the practicalities that have to be considered.

**Mr KERR**—One of the difficult issues, of course, is the private motor vehicle as a user—and not an insubstantial user. Again coming back to this question of whether it is the point of first consumption of carbon or how you operate in that field, presumably you would have to have some kind of imputed credit use going on to the suppliers of fuel, because you are not going to fine every private motorist, and then that comes through in a pricing signal. There is hardly any other mechanism that I think you could plausibly operate—and that is a reasonable segment of the market. I just wonder whether you have any thoughts there.

**Mr Jones**—The theory is right. I think I said to Dr Lawrence that potentially, technologically, there are ways that you could deal with that. Again I think you need to be very careful that you do not talk about transportation in a general sense. Certainly, commercial transportation needs to be treated differently from private transportation. That definition immediately creates a problem with farmers and with company cars and things like that.

**Mr KERR**—Is it possible to devise a scheme which, in a sense, would allow you to opt out? In other words, there would be any regime you can imagine. Say you have the notional allocation at the point of production of fuel, but you would allow anyone who wanted to take the trouble. In most cases the private user could not be bothered doing it, but a commercial operator of any scale could say, ‘We could get greater efficiencies out of this by ourselves being in the market, being innovative, doing things of this kind, so we will opt out of this system and become ourselves a trader.’ Is there a possibility of thinking of an opt in, opt out situation, or is it just too complicated to then have those kinds of design elements?

**Mr Jones**—It comes down to the basic question again of how you allocate your permits. If you allocate your permits point source by point source, then I think you have some real problems. If you allocate them corporation by corporation, and if my company has got 20 commercial vehicles, a head office which we own and control the electricity consumption in, and a production plant, then I get an allocation of permit for my total emissions within the corporation. I have got to be able to have flexibility within my corporation as to whether I go to more fuel efficient vehicles or I turn the lights off at 5 o’clock in the afternoon in the office or I put in a whole new series of pumps in the plant.

**Mr KERR**—Yes.

**Mr Jones**—My suspicion is that logic drives you towards the second sort of system because you get the bigger encapture rate.

**Mr KERR**—I understand that. I was assuming that was the sort of design system but, if you do that, how do you deal with the private motor vehicle? Logically you cannot exclude it from the system; it is a large consumer. I have not yet been able to imagine an architecture for this system that would be able say corporation by corporation allocation, yes, but individual by individual allocation does not seem to me to be a goer.

**CHAIR**—It is very complex.

**Mr Jones**—I think, basically, you have got three options. You have got the de facto allocation option which means you do it at the petrol pump, at the electricity meter or something like that.

**CHAIR**—Which is really a carbon tax, isn't it?

**Mr Jones**—Not necessarily.

**CHAIR**—By another name, is it?

**Mr Jones**—Or you do the technology option and you build it into the registration price. Many of the local authorities have a flat rate charge for water and electricity and then a user charge. You would change the flat rate component to be part of the permit, so there is that sort of system. Or there is the option to exclude private transport from the permit trading system. Put in another measure—that is where I would use those two horrible words.

**Mr KERR**—Other measures.

**Dr LAWRENCE**—Other tax.

**Mr Jones**—Other measures. Dr Lawrence just put a bead on it.

**Mr KERR**—What about design rules? There are other measures. I do not regard those words as having quite the horrendous—

**CHAIR**—It is an option.

**Mr Jones**—What about design rules? There are pricing mechanisms, but there are also design rules which go to limiting the marketability of certain kinds of vehicles. They are unattractive solutions generally that are telling people what they cannot purchase for various reasons.

**CHAIR**—This gives the manufacturer an advantage in the marketplace. That is what I was getting back to earlier about manufacturers. If they design an engine that is more efficient, it gives them an advantage in the marketplace, doesn't it?

**Mr Jones**—Yes. Depending on how the permits are allocated, as I said to Miss Kelly, there may well be a benefit to the consumer rather than a cost to the consumer.

**CHAIR**—I am probably leading the witness a bit here. Have your companies—and most of them are international companies—come to a conclusion that the Americans, who are very big players in any of these markets, have made up their minds that there is going to be a tradable scheme in emissions? Therefore are your companies positioning themselves in the marketplace?

**Mr Jones**—There are over 50 oil and gas producing companies in Australia, so it does not necessarily follow that all of them are American owned or large.

**CHAIR**—No; true.

**Mr Jones**—I think the contrary is true. Most oil and gas producing companies, in terms of numbers, are Australian owned and quite small. There is a big group at the top. How do you describe Woodside and BHP? I cannot talk about what judgments they have arrived at internally. I think it is common knowledge that all of them are, in one way or the other, looking at what a system might be and are beginning to position themselves. To give two examples that are publicly quoted, we all know about BP and Shell.

Stepping back, I think APPEA have formed the view that, in the current political climate in the United States, the only way ratification of the Kyoto Protocol is going to occur is if some sort of emission permit trading system is developed. If that is not done, then one of the two preconditions for getting Senate votes in the United States is not going to be there. There is going to be a huge drive in that domain to do it but, equally as much, the way we read the situation at present, there is a huge amount of pressure within the EU to try and stop that. It is difficult to see how that pressure between the two power blocs pans out.

**CHAIR**—Given that we have those dilemmas at present, do you see it in Australia's interest to be at the forefront and develop something like this instead of lagging behind and catching up later?

**Mr Jones**—I will use 'forefront' in two senses. We have always believed that it is absolutely essential in this debate that Australia fully understands the ramifications of all the options. Therefore, we need to be in the forefront of the thinking about how it is going and how it is working, but we are going to be a less than one per cent player in the market. To talk about our being in the forefront of the international negotiations is an entirely different question. At the end of the day, the forefront of the international



negotiations is the power game between the two big blocs—the US and the EU.

**CHAIR**—There was a bit of enthusiasm out of Kyoto from Australia that we could become a world sink. Do your companies see that as being a possibility for Australia? What do you think of sinks?

**Mr Jones**—I think the short answer is that we believe that all options should be open and that sinks are part of the suite of measures you have to be able to consider. We would want to be able to consider all measures in terms of determining what our appropriate response is at any time.

**CHAIR**—Do you see any opportunities? Are your companies looking at Australia in terms of opportunities for developing forests or whatever that may be offset on any trading scheme as credits?

**Mr Jones**—I would be surprised if there are not companies within the oil and gas industry doing it. If you look through the industry, very few of our member companies are producers of one type of energy and quite a few of them are conglomerates of various kinds. For example, I can think immediately of one that has both a large gas interest and a large forestry interest. I would be very surprised if that company is not internally considering the balance of responses. I can think of other energy companies, not necessarily in the oil and gas industry, in Australia who have several energy interests and a forestry interest. There is a whole suite of petroleum companies that are also renewable energy companies. They go from BP at one end down to companies like Energy Equity at the other end.

**CHAIR**—Thank you for appearing today.

Resolved (on motion by **Dr Lawrence**):

That, pursuant to the power conferred by paragraph (o) of standing order 28B, this committee authorises publication of the evidence given before it at public hearing this day.

**Committee adjourned at 10.16 a.m.**