

Emissions Trading Issues Related to Kyoto Protocol Ratification

The issues raised by ratification of the Protocol for the proposed scheme are substantial and complex. The scheme must be a coherent whole, and one capable of being nested within Australia's new obligations and opportunities under the Protocol. In our view, it would be preferable for the Government to address these major issues prior to attempting to settle the implementation detail - detail which is inherently interdependent with the grand design.

We've summarized some of these key issues for your consideration:

1. Will there be direct linkage with global emissions markets, such that Australian emissions permits would be interchangeable with other countries' permits? This could
2. If there is linkage, how to provide a safety valve against carbon price shocks due to higher price levels in mature trading schemes such as the EU ETS?
3. Which domestic actions and offsets should be eligible for early action credits and from what year?
4. How can the Australian government, when issuing emission permits, provide an appropriate level of surety for those holding and making investments and an equitable mechanism for sharing policy risk between industry and government.

Ratification of the Protocol raises a fundamental question about whether there will be direct linkage of the domestic emissions trading scheme with global emissions markets – such that Australian domestic emissions permits would be interchangeable with Australian Emission Units under the Protocol and any successor agreements, and similarly such that Certified Emission Reduction Units (CERs), Removal Units (RMUs) or Emission Reduction Units (ERUs) generated under the Protocol or successor arrangements would be eligible as offsets under the Australian domestic scheme.

If there is to be a direct linkage, then the viability of the proposed emissions fee price cap as a safety valve against carbon price shocks comes into question. This is particularly so for the initial period of the operation of the proposed domestic trading scheme where the price cap was seen by the Task Group report as sitting only a little higher than the expected market price. If allied to a provision that allows banking of emission permits, any attempt by the Australian government to provide for a soft transition to trading could lead to international warehousing of Australian Emission Units. The existence or otherwise of a safety valve price cap is directly relevant to the amount of compensation that would be payable to an eligible asset under the proposed scheme.

Ratification also raises the question of which domestic actions and offsets should be eligible for early credits and from when. It seems implausible that a "Kyoto forest" planted after 1990, but before 3 June 2007 should be eligible under the Protocol but not for an early action offset credit. Similar comments could be made in relation to international offset credits that would be eligible under the Protocol, but not necessarily be eligible under the scheme as proposed. As a matter of consistency early action and offsets carried out under State schemes and recorded with the Commonwealth and commenced before 3 June 2007 but otherwise meeting the criteria should similarly be eligible, at least in relation to emission reductions between 3 June 2007 and the commencement of the scheme.

An attractive element of the proposed scheme for industry, particularly those with major

long lived investments, was the intention to set forward emission paths for a ten year period with transparent review at five yearly intervals and compensation for those likely to be disproportionately affected.

Reflecting this long term target setting, industry expected that the Australian government would issue a substantial level of long dated emission permits – both as part of the compensation arrangements and through the market – which would provide an appropriate level of surety for those holding and making investments and an equitable mechanism for sharing policy risk between industry and government. If ratification leads to any shortening of the proposed emissions planning and permit allocation horizon this would be a retrograde step. Compensatory allocations of permits need to reflect the present value of a long term exposure to carbon prices.

As a party to an international scheme the Australian government needs to think carefully about the long term future emission reduction obligations it is prepared to accept and how these will be passed through to domestic emissions trading in order to establish a full and fair compensation value. Where compensation is provided in the form of substantially post dated permits it is also vital that these have an assured level of liquidity (there is no value in holding permits in a scheme that has been replaced by an international system, unless those permits have a full value transferability into the new scheme assured by the Australian government).