Emissions Trading: Good Governance Requires 100% Auctioning

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Every day seems to bring demands from yet another industry group or large corporation saying they should be compensated for the introduction of a national Emissions Trading Scheme (ETS). The usual argument goes that to refuse compensation would penalize these industries and their shareholders unfairly, and send a chill message to potential future investors.

In truth, such claims have little merit. However, it's hardly surprising that industry players are making the ask - governments are proven suckers when it comes to emissions trading. The EU ETS (the world's first and largest emissions trading scheme) initially gave almost all its permits away to large emitters, free, as compensation for the impact of introducing the scheme in the first place. Typically these corporations promptly charged their customers the full market permit price and pocketed the difference. So while the EU ETS may not have had much impact in reducing greenhouse emissions, it has certainly delivered extraordinary windfall profits to many of the EU's largest emitters, especially electricity generators.

The EU now seems determined to enforce 100% auctioning of permits for the electricity sector as soon as possible, while the key States in the US Regional Greenhouse Gas Initiative Scheme (an initiative starting in 2009) have also mandated 100% auctioning.

In Australia, the clearest case for 100% auctioning has been made by the Garnaut Review. They note that giving large emitters free permits will almost certainly have adverse equity impacts - as seen in the EU. Auctioning all permits, instead, makes government revenue that they can use to compensate those most in need of support - households, communities in painful transition and some Trade Exposed and Energy Intensive (TEEI) industries competing against international producers that do not face an equivalent carbon price. For its efforts, the Review now finds itself under attack from a growing number of industry players and the occasional State Government.

In truth, however, Garnaut has (if anything) understated the adverse impact of compensation for large emitters by arguing that compensation is largely an equity issue - who pays and who profits. In practice, compensation will also have an impact on the cost-effectiveness emission reducing scheme. Firstly, it puts the focus of industry players on trying to maximise their compensation rather than finding new and cheaper ways to reduce their emissions, encouraging the 'victim mentality'. Even more importantly, compensation for large emitters risks undermining the good governance that is essential to deliver an effective ETS.

"Compensation" is generally understood to mean righting a wrong or imposition placed upon some party. Putting a price on emissions doesn't represent an additional imposition on emitters, but rather, the removal of a public subsidy. Emitters have been knowingly receiving this subsidy since at least the Rio Declaration in 1992. The public actually has a pretty good case for reparations from those industry players that played a role in delaying action to end this subsidy through their lobbying and other efforts.

Furthermore, arguing that introducing an ETS without compensation will have an adverse impact on investor confidence in good governance has it the wrong way around. Large emitters are typically owned by investors through their shareholdings. Most investors over the last decade have made the judgment that climate change is a problem, and that 'polluter pays' policies were coming. Presumably, some other investors have judged that there wasn't a problem or, worse, that governments would inevitably yield to corporate demands for so-called compensation. Paying such compensation therefore rewards the wrong group of investors - those taking a bet against good governance.

As for industry leaders, governments should be supporting those trying to do the right thing. If good corporate citizens see others being rewarded for claiming victim status they are almost obliged to attempt the same thing. After all, when governance is weak you'd better be at the table in Canberra or you'll probably end up on the menu.

And what of the public? If governments can't stand up to unreasonable demands for compensation then people have every reason to question its ability to respond effectively to the climate change challenge. Public cynicism and disengagement are a likely and understandable outcome.

For all these reasons, a Federal Government decision for 100% auctioning of permits is one of the key decisions on which their wider policy success lies. It will provide revenue and a more equal platform for those who really do need help in the transition to a carbon constrained Australia. If such a decision is beyond Government, we can't expect even good corporate citizens to waste time thinking about how to reduce their emissions - they'll all be booking their tickets to Canberra to fight for a seat on the gravy train.

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