

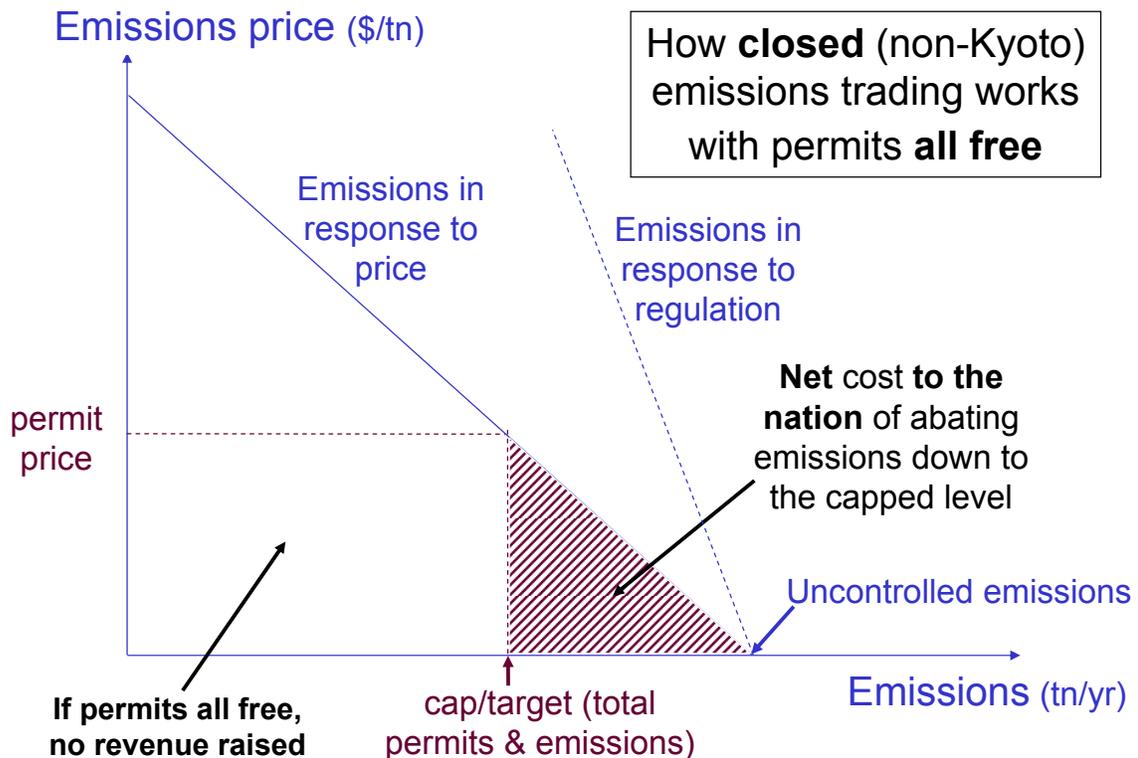
# PERMIT ALLOCATION AND THE USE OF PERMIT REVENUE

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**Emissions Trading – Getting Design Elements Right**  
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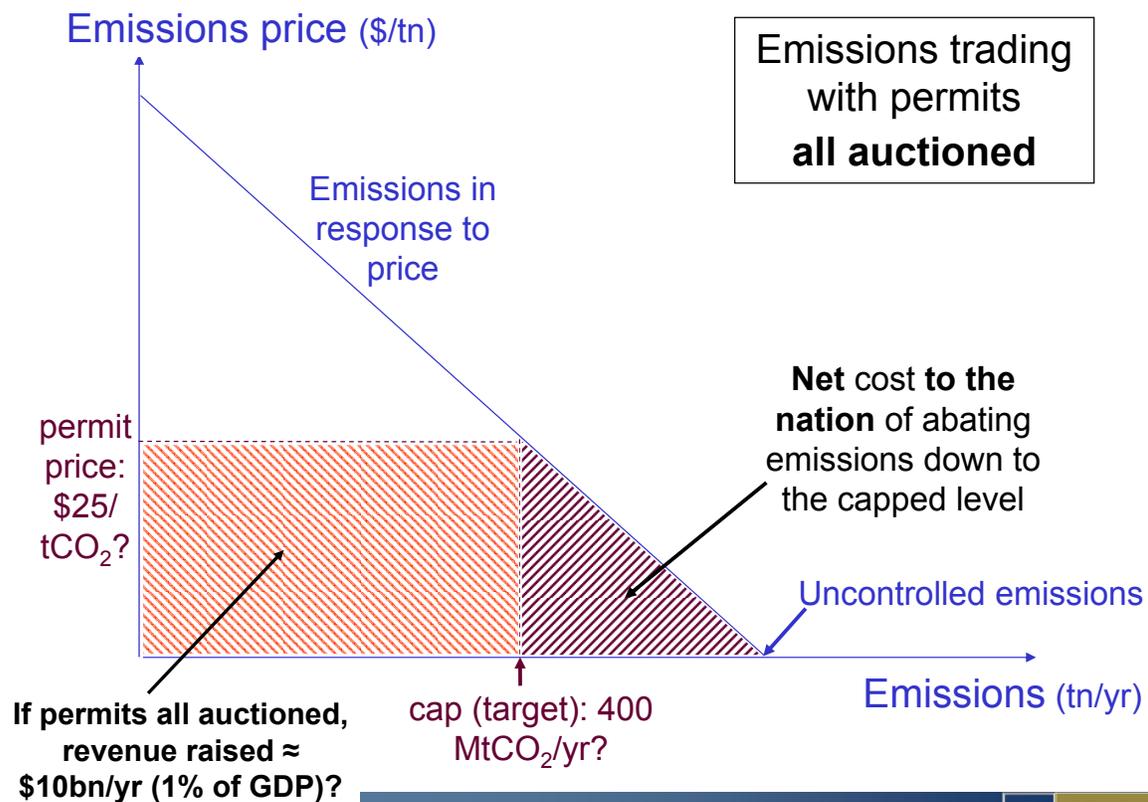
## With free permits, who finally bears the net costs?

- All depends on nature of pollutant and who gets free permits
- Carbon-burning central to economy: not unwanted side effect like sulphur-burning

→ **carbon fuel demand inelastic** (c.f. supply): most of carbon permit price passed on to **final consumer**, as higher prices for electricity, petrol, steel, etc

→ net **control costs** fall mainly **not on direct emitters**

→ if permits **all free** to emitters, emitters make **big windfall profits**, and consumers and some workers bear bigger losses. Witness \$bn profits to electricity generators, and higher electricity prices, in Phase 1 of EU ETS.



## Allocation of permits should be “90%” a wealth transfer

- If permits allocated instantly, fairly and on **once-and-for-all** basis (so they're property rights), who gets them hardly affects emissions, outputs, prices, jobs, or total costs, i.e. **economics**, just individuals' wealth/income, i.e. **politics**.
- Other “10%”? Small **wealth effect** on economics (Coase). E.g. companies with permits may choose not to close down and sell permits, even when profitable to do so; and govt spending of permit revenue may change economics a bit.

BUT if allocation not instant, possibility of **future, free permit** allocation may create **perverse incentive** to raise emissions now in hope of higher free permit allocation later.

AND if allocation unfair, may give emission trading bad name  
→ harms future use of market mechanisms, hence effic'y.



## With permits all auctioned, no allocation debate?

Not really – many competing claims on auction revenue:

- **Compensation to consumers** (but not in a way that negates carbon-saving behaviour caused by carbon price)
- **Compensation to workers** made unemployed (but not in a way that negates the carbon price signal to lose that job)
- **Support low-carbon technology** and **energy efficiency** to overcome well-known market failures for innovation and for information (but what are the best support mechanisms?)
- **Reduce existing taxes** like income tax, which cause deadweight losses throughout economy

**but** part of normal govt choices – no firm-level models needed



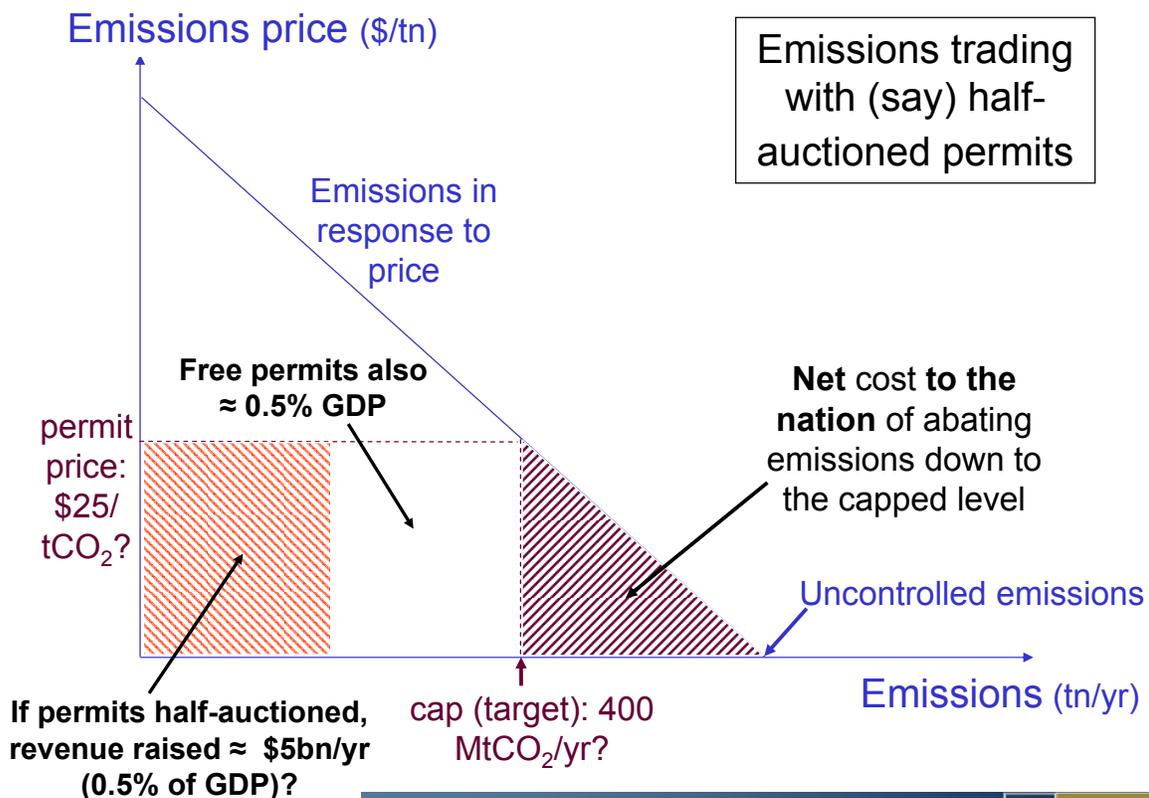
## Coalition Government July '07 Climate Change Policy

“provides an up-front, once-and-for-all, free allocation of permits as compensation to existing businesses identified as likely to suffer a **disproportionate loss of value** due to the introduction of a carbon price”

“free allocation [to ameliorate] the carbon-related exposures of existing and new investments in **trade-exposed, emissions-intensive** [TEEI] industries”

“Govt will move early to establish the **information base** on which free permits will be allocated... Treasury will model...impact on different sectors of the economy”

“agrees in principle...that the **use of revenue** to support low emissions technology and energy efficiency is a high priority...will consider the use of auction revenues in more detail once the design details for the emissions trading system are settled”



## Comments on Coalition scheme (1):

- Why no consideration of **border taxes** as alternative to conditional free permits for carbon-intensive, trade-exposed businesses?
- Why not consider **full auctioning**, to avoid arguments over and delay caused by modelling disproportionate losses of value? (But still needs to be debate over use of auction revenue.)
- Why no consideration of **compensation for consumers or workers**? Why only low-carbon technology and energy efficiency considered as uses for revenue? Danger that political backlash could reduce potential for future cost-saving uses of market mechanisms of environmental protection.



## Comments on Coalition scheme (2):

- What about **perverse incentive** (until scheme starts “no later than 2012”) to increase emissions, in hope of getting more free permits, while info gathering and modelling is done?
- Can this be neutralised (or better) by “Abatement Incentives Prior to the Commencement of the Australian Emissions Trading Scheme [AETS]” (the early action discussion paper)?
  - Tricky, since: “abatement activities [in covered sectors] undertaken prior to 2011 should only receive credits until 2011, even though these credits would be recognised within the trading scheme thereafter.”
  - So: “...unlikely that significant volumes of early abatement action can be credited [before] 2011. In addition, assessing the additionality of abatement activities in covered sectors becomes more complex with the announcement of [AETS].”



## Federal Labor's Nov '07 "Clean Energy Plan To Help Tackle Climate Change"

\$140m **per year** averaged over 2008-2011 of **net** new spending:

- + \$75m/yr Renewable Energy Fund
- + \$30m/yr Energy Innovation Fund
- + \$75m/yr Clean Coal Fund
- + \$60m/yr Clean Business Fund (Green Building Fund, re-tooling for climate change, Climate Ready)
- \$100m/yr from cancelling Low Emissions Technology Demonstration Fund, GHG Abatement Program, Commercial Ready

"Federal Labor will implement an emissions trading scheme by 2010 and will make the investments today that are required to help the economy prepare for emissions trading."



### Comments on Labor scheme:

Spending programs costing \$240m/yr should be compared to early action ideas, costing only admin. Will progs be ended after AETS starts in 2010? High admin cost for 2yr scheme?

Why **nothing on permit allocation** worth c. \$10,000m/yr – not even minimum % to be auctioned?

So still use Coalition compensation approach to permit allocation?

Then above comments also still apply...

...with addition of **reduced incentive for abatement** right now, until all the spending programs start...

...and does number of spending programs suggest **more faith in government than in market price** created by emission trading as way of picking winners among competing technologies??

