

# PURCHASING UNITS FOR AUSTRALIA

# 5

If the government decided to use international units to help meet Australia's emissions reduction targets, it could either buy international units directly through a government purchase program or design domestic policies to encourage the private sector to purchase international units.

Many other countries have government purchase programs, providing possible models for designing and implementing an Australian program. Experience suggests that a government fund would be reasonably straightforward to establish, govern and administer. It would provide a flexible way to help meet Australia's targets at modest costs.

Several countries have designed domestic policies to encourage their private sectors to purchase international units. Each of these countries has clear rules to guide private players on the quantity and type of international units that can be used, as well as on governance matters.

Australia could buy international emissions directly through a government purchase program, design domestic policies to encourage private sector purchases or both. As discussed in Chapter 1, both approaches could be relevant to Australia:

- A government purchase program could establish a 'strategic reserve' of international units for use in the event insufficient domestic reductions were available to achieve the minimum 5 per cent target, or to do better than that minimum target.
- Domestic policies could be designed to allow some businesses to access international emissions reductions as a compliance option in domestic arrangements.

This chapter discusses how these approaches might be implemented, drawing on the experiences of other countries.

## 5.1 GOVERNMENT PURCHASING

Several governments have established purchase programs to buy international units built around a number of considerations:

- governance
- size of the fund
- administration
- approach to market.

## 5.1.1 GOVERNANCE

As for any government expenditure program, a fund to purchase international units would require robust governance arrangements.

Various models have been adopted in other countries. Some have established their funds and governance arrangements through specific legislation. Others have established purchase programs through their normal budgetary processes, applying existing public procurement arrangements. Australia could consider both approaches.

In some countries governing boards have been established to oversee the operation of their purchase programs and to advise responsible ministers on funding decisions. This has considerable appeal from a governance perspective.

Most purchase programs have clear objectives to guide the operations of the fund. The majority of funds established in the last decade have focused on purchasing Kyoto Protocol units for compliance with first commitment period targets. Most of the European funds, for example, purchase a variety of Kyoto units primarily for compliance with national or regional Kyoto targets. Some other funds, however, have additional objectives such as broader foreign policy, trade and development. The French Global Environment Facility, for example, has a broad scope, ranging from developmental objectives and providing Official Development Assistance to financing climate change mitigation as well as purchasing units through the CDM and JI, and in REDD+ projects.

The primary objective of an Australian Government fund would be to help meet its 2020 target but other, broader policy objectives could also be considered.

## 5.1.2 ADMINISTRATION

Program administration involves various functions including financial management, project assessment, risk management, procurement, contract management and market analysis. Some of those activities require specialised skills, while others are more straight-forward.

Many governments have established a dedicated team to administer their programs. The size and skill set of the team depends on whether or not some of the activities are contracted out. The French Global Environment Facility undertakes most of the administration inside of government and employs about 10 full-time staff and an additional 10 experts on its Scientific and Technical Committee. By contrast, the Norwegian program is handled by an internal team of two people and relies more on procuring specialist services from the private sector. Another option is to delegate the administration of the fund entirely to a third party. The Austrian scheme is overseen by an advisory board and the relevant ministry, but is managed by *Kommunalkredit Public Consulting GmbH*, a private sector consultancy.

Many national and multi-national funds have been established which are administered by multilateral institutions including the World Bank and the Asian Development Bank. Participating countries join the fund, provide funding and receive credits in return. These agencies offer significant expertise, experience and high fiduciary standards.

Whether a dedicated team were to be established or much of the administration were to be outsourced, experience suggests administering a government fund is unlikely to be very complicated or resource-intensive.

## 5.1.3 ACCESS TO MARKET

A purchasing program might access the market through different channels:

- tender
- multilateral fund
- private institution or brokerage service
- exchanges.

The choice of approach depends in part on whether a fund targets the primary market (that is, buys units directly from project developers) or the secondary market (buys units that have already been issued). Again a number of approaches to both primary and secondary markets could be considered, having regard to, among other things, the magnitude of possible purchase and risk management issues.

### TENDER

Several government purchase programs have run tender processes that involve calling for proposals and selecting projects based on the best value for money. This is similar to the process proposed for the ERF, where project developers will bid price and volumes to the government.

Tenders are frequently used to source units from the primary market and can be tailored to match any purchasing preferences. They can provide an efficient way for the government to discover a 'market' price of units.

### MULTILATERAL FUNDS

Several carbon funds have been established by multilateral banks. Investors in these funds receive units in return for their investment. They have been established for both single and multiple national investors, some have also allowed for private investor participation.

The focus of these funds has reflected the mandates of the administering multilateral agencies to support developing countries. Multilateral agencies have significant institutional capacity to develop and implement emission reduction projects in developing countries. The funds have been directed predominately at new projects and the development of market mechanisms. As they have objectives other than generating credits (such as promoting sustainable development and reducing poverty), the cost of generating units in these funds can be higher than those with specific commercial objectives.

### PRIVATE INSTITUTION OR BROKERAGE SERVICES

A number of financial institutions, project aggregators and brokers operate in the market. They offer a range of products (such as spot, forwards and options contracts) to help their customers manage price and delivery risks. They charge a fee for their services or reflect the cost of service in the price of units.

### EXCHANGE

Funds can also purchase international units on existing exchanges. These exchanges provide clear price information, reasonable liquidity and a range of products including spot and forward contracts. At present they service predominantly the European market and the units traded reflect the compliance rules in the EU ETS. If Australia was interested in purchasing the same units as those allowed in the EU ETS (with no other preferences or restrictions) purchasing units on these exchanges could be an efficient and straight-forward approach. Exchange-based purchases could be less suitable if Australia wished to purchase a subset of units allowed in the EU ETS.

Exchange prices in the past have been higher than those in the primary market (to account for the lower delivery risk), but are at historically low levels.

## 5.2 PRIVATE SECTOR PURCHASING

Private sector purchases of international emissions reductions have been a driving force in the development of the global carbon market. The involvement of the private sector has helped to develop risk management arrangements (such as forward contracts and options), to foster experimentation and knowledge transfer, and put pressure on international governance arrangements (such as the CDM Executive Board) to improve their performance. This section looks at how domestic policy might be designed to encourage private sector purchases of international units.

Several countries allow international units to be used by private entities for compliance with domestic policies, including:

- the EU ETS, which gives liable facilities flexibility to use a limited number of international units to meet their compliance obligations
- New Zealand, which provides for international units to be used against obligations under its domestic scheme
- Japan, where businesses purchased international units to achieve their targets in the period to 2012
- South Africa, where the Carbon Tax will allow CERs to be used against liabilities (these are likely to be limited to those generated in South Africa)
- the Republic of Korea and China, which will allow CERs or their equivalent to be used under their proposed emissions trading schemes (like South Africa, these are likely to focus on units generated domestically).

While these policies are designed with specific national circumstances in mind they all seek to lay down clear rules to guide the private sector in respect of:

- quantitative limits—specifying how much of an entity's obligation can be offset by using international units
- unit types—specifying which units the private sector is allowed to use, and those which are not allowed
- acquittal process—transferring units to acquit against the entity's emissions liability, including establishing registries and accounts.

Within these sets of rules, the private entity determines whether they will pursue the opportunity and the units they wish to purchase. The government then counts the international units purchased by the private sector towards the national target. If Australia were to allow for private sector purchases under its policy considerations, it would need to determine how this might best be done and reflected in appropriate rules and processes.