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Working Party No. 2 on Competition and Regulation

EMISSION PERMITS AND COMPETITION

-- Chile --

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The attached document is submitted to Working Party No. 2 of the Competition Committee FOR DISCUSSION under item VII of the agenda at its forthcoming meeting on 25 October 2010.

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1. Chile's legal and institutional environmental framework

1. Chile's Environmental Policy stands on the concept of sustainable development, a strategy aimed at reconciling environmental protection with economic growth in a context of social equity and public sector's transparency. Its principles ensure coherence and pervade the legal, institutional and instrumental aspects of the government's environmental management.

2. Chile's Constitution contains three provisions concerning the environment. No. 8 and 24 of Article 19 declare that: a) citizens have the right to live in a pollution-free environment, the State being accountable for protecting this right and preserving nature; b) property rights are restrained by their social function, that is, the country's interests, national security, health, public use and conservation of environmental heritage; and c) as a guarantee of the above-mentioned rights, Article 20 of the Constitution enshrines the remedy of protection, which may be called upon by any party undergoing deprivation, disturbance or threats in his right to live in a pollution-free environment (Article 19, No 8) by an illegal act attributable to a precise authority or person. These Constitutional rules imply that, unlike aspects such as economic policy, environment issues are a State responsibility and that legal constraints on some rights or liberties can be imposed in this regard.

3. The General Environmental Framework (Act N° 19.300), enacted in 1994, has been substantially amended in 2010 by Act N° 20.417¹. The Act originally created enforcement mechanisms, the environmental protection fund, and government institutions in charge of environmental issues. It also defined key concepts for generating and ascribing duties and liabilities with reference to biodiversity, climate change, pollution, conservation of environmental heritage, nature preservation, and environmental impact or damage.

4. A number of management instruments –the main topics of the General Act No. 19.300 and related legal bodies- are also provided: Environmental Impact Assessment System; Environmental Quality Standards, Nature Preservation and the Conservation of the Environmental Heritage; Emission Standards; Management, Prevention and Decontamination Plans; Citizen Participation; Liability for Damage to the Environment; Education and Research; Environmental Protection Fund; and Strategic Environmental Assessment².

5. From 2010 onwards the new institutional arrangement considers the creation of the Environmental Ministry, in charge of environmental policies and regulations; the Environmental Evaluation Service, for the administration of the Environmental Impact Assessment System; and the Superintendence of the Environment as an enforcement and compliance agency. The Superintendence's powers of supervision and sanction will be effective once the bill introducing the Environmental Tribunals, which is now in Congress, is enacted.

2. Locally transferable permits

6. Tradable emission permits (EPs) are an environmental management instrument in Chile's environmental regulations. EPs are one of the main economic instruments for preventive and decontamination plans and in emission standards associated to particular areas. The authority may launch a

¹ This amendment included the creation of the Environmental Ministry, the Environmental Evaluation Service, the Superintendence of the Environment and the Ministerial Sustainability Council. Besides, a bill establishing Environmental Tribunals is currently under discussion in Congress.

² The 2010 amendment introduced the Strategic Environmental Assessment instrument, which will come in force together with its related regulation.

prevention or decontamination plan in specific areas when an environmental variable reaches between 80% and 100%, or exceeds, the values set by an environmental standard.

7. Issued by the Ministry of Health, Decrees No. 4 (1992) and No. 812 (1995) create and regulate a compensation system for particulate matter emissions by stationary sources. A compensation system for new activities is included in the Metropolitan Region Decontamination Plan³ whereby projects with an annual emission value higher than defined in the plan, should compensate 150% of that value.

8. Stationary sources permits were initially assigned caring for “grandfathering” clauses⁴, upon the emissions declared until December 1997 by sources operative by March 1992. An emission benchmark for these facilities was in force already, given that a reduction program had been previously set up. Later modifications of the original facilities must also compensate their emissions.

9. The compensation and technical requirements for those sources is authorized by the Ministry of Health, and only compensations between sources ensuring that their emissions’ composition is similar are allowed.

10. The Environmental Permit shapes the procedures and technical requirements for the compensation of other sources’ emissions, i.e., particulate matter during the building of a facility. Permits are granted by the Regional or National Commission for the Environment after their evaluation by the Environmental Impact Assessment System.

11. These permits are traded by firms on a bilateral basis, along with legal documents and technical information required to guarantee that the compensation and/or the emission reduction have been carried out.

12. The system operates within a specific geographical area benefiting from a decontamination plan and command & control instruments, such as emission standards. It is therefore unlikely that premises that should compensate their emission will become smaller in order to by-pass the regulations.

13. A similar system is in place for the control of nitrogen oxides emissions, consisting of a reduction program for current large emitters and compensation for new facilities. The compensation of emissions in the Metropolitan decontamination plan is mandatory for any activity or new facilities that emit over certain values of carbon monoxide, sulphur oxides and organic volatile compounds⁵.

14. A case depicting the compensation system is worth mentioning. In 1997, *Central Termoeléctrica Renca*, a thermoelectric power generator, had to substitute its fuel and sought an opinion from the environmental impact assessment system. The decision approving the change ordered the plant to compensate its nitrous oxides emissions. At that time, the government, in turn, was promoting the use of catalytic converters by taxicabs so as to reduce their emissions of atmospheric pollutants. Thus to satisfy

³ D.S. N°16 of 1998 issued by the Ministry of the Presidency was updated on 2004 and on April 2010.

⁴ When rules are changed, these clauses allow actions taken before a certain date to remain subject to the old rules. In other words, it is a statutory or contractual willingness to allow some activities or former rights to stay valid despite new rules precluding it. For instance, downtown regulations can no longer allow gas stations there, but the one operating in the area before the law came into effect can stay in its “grandfathered” business.

⁵ Both authorized emission values and pollutants included were modified in April 2010.

the emission compensations, the approval involved the destruction of 129 taxicabs, paid by the power generator to their former owners, thus enabling them to buy a new car with catalytic converter⁶.

15. A further development is the Ministry of Public Works' intention to hand the administration of public parks and green areas to private firms under a concessions scheme. The administrator will be qualified for selling decontamination bonds of particulate matter to activities needing to compensate their emissions. The ensuing resources will directly go to the maintenance of green areas⁷.

16. With the aim of enhancing the compensation systems, a bill acknowledging the issuance of decontamination bonds was dispatched to Congress in 2003⁸.

17. One of the government's environmental priorities is a legal framework for an emission-trading scheme fitting assorted pollutants and geographical areas. The new Environmental Ministry has announced the review and amendment of this bill, with the aim of making effectively available an emission trading system in Chile.

3. Climate change and greenhouse gases mitigation

18. Chile is a developing country willing to contribute to the lessening of the global warming problem, although it contributes a mere 0.2% of global emissions. This country will freely take national the appropriate mitigation actions to achieve a 20% deviation below the "Business-as-Usual" (BAU) emissions growth trajectory by 2020, as projected from 2007, a target that calls for foreign support. Chile will mainly address energy efficiency, renewable energy, and Land Use Change and Forestry measures⁹.

19. As a non-Annex I country, Chile has no emission commitments but has participated in the international CO2 markets either on a voluntary basis or under the Kyoto Protocol's Clean Development Mechanism (CDM). Our country has been very active in the development of CDM projects. According to UNFCCC's CDM statistics, the expected average annual CERs from 38 registered projects in Chile amounts to 1.25%.

20. The Santiago Climate Exchange (SCX) proposal was introduced in November 2009. This is a private initiative seeking to start and develop a Greenhouse Gases reduction industry, with state-of-the-art processes and carbon bonds eventually tradable in the American or European markets. This initiative is still in an initial stage, so no conclusions about its effects on market are available.

4. Competition authorities and the development of a market for emission permits

21. Competition authorities have not yet been directly involved in the development of an emission permits system.

22. Economic instruments for environmental management and regulation have been in use ever since their inception in mid 90's. Competition authorities, though, are aware that market solutions are

⁶ Environmental Qualification Resolution of the "Central Termoelectrica Renca y Nueva Renca", Project. Res. Ex. N° 007/96, 30.10.1996. Available at https://www.e-seia.cl/expediente/expedientesEvaluacion.php?modo=ficha&id_expediente=43

⁷ Newspaper "La Tercera" 09.05.2010, page 10.

⁸ Bulletin 3290-12, July 2003.

⁹ Chile's letter to UNFCCC on the Copenhagen Accord's Appendix II -Nationally appropriate mitigation actions of developing country parties.

increasingly been used nowadays by Environmental Authorities as a complement to the usual command & control instruments.

23. Environmental regulations should consider the competition policy approach, most of all in the design of an emission permits trading system. A recent experience is worth mentioning related to the management of fishing permits or quota allocation in the fishing industry.

24. Extractive fishery is highly regulated in Chile, by the "General Act on Fisheries and Aquaculture"¹⁰. Overall, this Act regulates this activity largely through command & control instruments such as annual quotas by species in a given area, or Total Allowable Catch; biological close season; minimum size or weight extraction per species in a given area, and size and features of the arts and fishing gear, among other¹¹.

25. Following the evolution of global fisheries management, in 1992 Chile started to regulate this activity by means of economic instruments¹², introducing an individual transferable quotas (ITQ) system, which tradable character has been limited in practice.

26. From 2002 onwards a Maximum Catch Limit per Boat Owner system (LMCA¹³) was introduced under Act 19.713 for industrial fishing only. This new system allocated individual fishing quotas based on a historical catch and investment allocation criterion.

27. Act No. 19.713 (LMCA) will expire in December 2012. In the face of this forthcoming event, the arrangement for access to fishery resources has triggered a debate in the industry on the revision of the LMCA's current regulatory scheme.

28. Additionally, the debate has moved to the competition arena, triggered by a request for a Competition Tribunal decision by a market player in a non-adversarial procedure. This firm initially requested, among others, a modification of the initial allocation system of fishing rights based on historical catch criteria, claiming market foreclosure effects.

29. The FNE framed the discussion as an issue of productive efficiency rather than a problem of allocative efficiency. The grounds for this approach were that in this particular case, in the downstream market, the product was considered a commodity (fish flour) and thus no serious potential risks towards final consumers were identified. On the other hand, the FNE identified that the potential competition problems in the market for fishing quotas should be addressed with an efficient transferability system for the ITQ, rather than amending the initial allocation provisions.

30. In its report to the TDLC the FNE recommended that "in the context of a new fishing regulation, a proper secondary market for extractive fishing rights should be promoted, leading to an efficient

¹⁰ Act 18.892 of 1989 and subsequent amendments.

¹¹ Ibid. 1, Title III, paragraph 1, Articles 3, 4 and 5.

¹² Individual transferable quotas belong to a class of instruments known as "tradable permits... established by the Government for pollution or resource use. ...[the government] distributes auction permits and controls compliance of the system" CEPAL (2001), Serie Medioambiente y Desarrollo N° 31, p. 16.

¹³ Act No. 19.713, *Límite Máximo de Captura por Armador*.

allocation of extraction rights”¹⁴, provided that “two essential assumptions come together to make this happen: that property rights are well defined and that transaction costs are not too high”.¹⁵

31. This non-adversarial case is still pending before the Competition Tribunal. The decision that will be issued -although not legally binding for the regulators- may provide a competition perspective in 2012 when the current quota allocation system will be revised.

¹⁴ FNE report of 06/09/2010, paragraph 113, page 39.

¹⁵ FNE report of 07/30/2010, paragraph 3, page 1.