

## THE LANDFILL ALLOWANCE TRADING SCHEME (LATS)

### Trading of allowances

1. What are the benefits of allowance trading?
2. How much are allowances expected to cost?
3. How are councils meant to plan for the long term with no indication of the likely cost of allowances?
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6. Do traded allowances have to be used in the year which they have been purchased?
7. Is the use of brokers compulsory?

### TRADING ALLOWANCES

#### 1. What are the benefits of allowance trading?

The advantage of a trading scheme is that it overcomes the fact that the diversion costs that each WDA faces will differ according to their particular circumstances. WDAs with low diversion costs will have an incentive to divert as much biodegradable municipal waste from landfill as possible, selling their surplus allowances to WDAs that face a higher cost of diversion. Trading also help local authorities find the most cost effective way of diverting from landfill that reflect their local circumstances.

#### 2. How much are allowances expected to cost?

Government does not restrict the price of allowances so there will be neither a price floor nor a price ceiling, although the WET Act does give the Secretary of State the power to control prices if it is deemed necessary.

The actual price of allowances is determined by interaction of demand and supply for allowances. The demand and supply of allowances is based on the cost to different waste disposal authorities of diverting waste from landfill. If the market operates efficiently, the price of allowances would be between the additional cost of diversion and £150, the amount an authority would be fined for failing to hold sufficient allowances for the BMW sent to landfill. The average cost of an allowance has been dropping each year since the scheme began.

However, there are two potential short term market failures which could mean that the price of allowances falls outside the range identified above:

- If the majority of waste disposal authorities decide to meet or exceed their own targets, there could be an excess supply of allowances on the market; and
- At the other end of the spectrum, if too many waste disposal authorities rely on purchasing allowances to meet their targets, there could be excess demand in the system.

Both of these potential short term market failures are more likely to occur close to, or in, a target year, where the scope for banking and borrowing is reduced; they show the importance for waste disposal authorities to undertake waste management plans for the whole period, make use of the banking and borrowing mechanisms to re-profile their allowance trajectory to match the profile of expected need and to participate in, and take account of the price signals from, the futures market.

**3. How are councils meant to plan for the long term with no indication of the likely cost of allowances?**

The cost of buying allowances, or the income from selling allowances, are one part of local authorities waste management costs and should be viewed as part of the overall waste strategy and not in isolation. By banking and borrowing allowances (where permitted) authorities can minimise their exposure to the market in any year. Authorities can also make use of forward trading to overcome some of the uncertainty associated with the price, demand and supply of allowances. By agreeing now to trade allowances for a future year at a fixed price, authorities will be able to plan more effectively and budget for the purchase or income from allowances.

**4. Does the Landfill Tax impact upon allowances in the medium term?**

The Landfill Allowance Trading Scheme and the Landfill Tax escalator are designed to ensure that the UK meets its obligations under the Landfill Directive in the most cost effective way. Local Authorities are fully compensated for expenditure on the Landfill Tax Escalator in that Landfill Tax receipts from local authorities will be returned through the Environmental, Protective and Cultural Services (EPCS) block, in line with the general EPCS formula. The tax increase will therefore be revenue-neutral to local authorities. However, the amount of Landfill Tax that individual authorities have to pay will depend on how much they landfill. This means that for individual authorities the net financial result will depend on their success in diverting waste from landfill.

**5. What is meant by 'non-monetary trading'?**

Non-monetary trading is the term used for those trades where one authority provides a service on behalf of another in exchange for allowances.

**6. Do traded allowances have to be used in the year which they have been purchased?**

Subject to the restrictions governing the banking and borrowing of allowances, waste disposal authorities are able to buy allowances and then bank them for use in later years.

**7. Is the use of brokers compulsory?**

The use of brokers is simply an option; it is not compulsory. Waste Disposal

Authorities which choose to trade without brokers will need to seek legal advice on whether they need to hold Financial Services Authority authorisation. This will depend on whether their activities are covered by the Financial Services and Markets Act (2000).