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These other participants are the so-called market makers, who respond to the natural buyers and sellers by being prepared to enter into both buy and sell transactions at the right price. Most properly functioning markets have them. The emissions trading scheme needs to encourage the participation of market makers in order to be able to perform its price discovery and resource allocation functions effectively.

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A third factor involves the role of government. Market makers could be concerned that the government has sole responsibility for the creation and pricing of emissions units, or for linking the emissions trading scheme to trading systems overseas.

On one hand, the creation of structures to allow Australian emissions units to be converted into internationally traded units will be seen as a plus, as an increase in market size holds clear benefits. On the other hand, exposure to international markets means that unit value can be affected by international risks.

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The architects of Australia's emissions trading system need to look at the way that its structure could inhibit the formation of a real market. Emissions units don't just need to be tradeable. They need to be traded.

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