

Discussion Paper: Possible Design for a National Greenhouse Gas Emissions Trading Scheme

Information Sheet No. 13

International linking

Any Australian emissions trading scheme could potentially be linked with schemes operating elsewhere in the world.

Such schemes include arrangements under the Kyoto Protocol, the European Union Emissions Trading Scheme, and the developing Regional Greenhouse Gas Initiative in the north-east of the United States.

European Union Emissions Trading Scheme (EU ETS)

The EU ETS is a “cap and trade” scheme that commenced in January 2005. More than 11,000 installations are covered in 25 EU member states, representing about 50% of total EU CO₂ emissions. (See www.ec.europa.eu/environment/climat/emission for details).

Regional Greenhouse Gas Initiative (RGGI)

The RGGI is a “cap and trade” scheme that is scheduled to start in 2009. It covers a number of States in the north east of the USA. Final details on coverage, rules and caps are being examined. (Details are available at www.rggi.org).

Why link?

The basic rationale for considering bilateral linking is the same as that for introducing an emissions trading scheme.

That is, an emissions trading scheme allows the overall cost of meeting a cap to be minimised by allowing firms with a high cost of abatement to purchase abatement from firms with a low cost of abatement (see [Information Sheet 1](#)).

By increasing the scope of any Australian emissions trading scheme, international linking broadens access to cost-effective abatement.

While the cost of limiting emissions varies considerably between regions, the benefit for the atmosphere is the same, wherever the action is taken.

Kyoto Protocol Market

The Kyoto Protocol incorporates three different flexibility mechanisms that allow trading in emissions:

- Clean Development Mechanism (CDM)
- Joint Implementation (JI)
- Emissions Trading (ET).

These mechanisms enable participants to access cost-effective opportunities to reduce emissions or to remove carbon from the atmosphere in other countries.

Two of the flexible mechanisms (CDM and JI) are so called project based approaches, where a company or government invests in

an emissions reduction project in another country.

For example, a company from Spain invests in a wind farm in China, thus reducing emissions from electricity that would otherwise have been produced by burning fossil fuels. The company then gets credits which it can sell – for example, to the government of Spain, which can use them to meet its Kyoto Protocol target.

Linking Scenarios

There are two possible ways of linking schemes:

- **bilateral linking** of two schemes, which involves mutual acceptance of credits or permits between schemes
- **unilateral linking** of one scheme to another where the two markets remain separate but firms from one of the schemes would be allowed to purchase permits or credits from other schemes and then use them for compliance.

Proposed international links

The Discussion Paper acknowledges that **bilateral linking** might be desirable in the **longer term** but notes that the principal objective of designing the National Emissions Trading Scheme should be to establish a strong domestic market in Australia.

Given that international negotiations would be required to establish bilateral links with other schemes, **bilateral linking** is an

area that would be more appropriately dealt with by the Commonwealth Government.

However, it is proposed that **unilateral linking with the CDM** be established **from the outset** of the scheme.

This would allow firms to buy credits created by CDM projects (known as Certified Emissions Reductions or CERs). The CERs would then be converted into Offset Credits under the Australian NETS. The Offset Credits would then be used by the firm for compliance or for trading.

Impacts of unilateral linking

Unilateral linking has the advantage of incorporating Australia into the international carbon market while providing an additional ‘safety valve’ for prices of domestic offset credits and permits.

If the price of domestic permits is less than the price of international permits, firms would not use international permits to meet their obligations under the emissions trading scheme.

If the price of domestic permits reaches the price of the international permits, participants would buy international permits—thus the price paid by firms in Australia could not exceed the price of international permits.

The Discussion Paper asks for comments from stakeholders on whether any limits or restrictions should be placed on the number or type of credits from the CDM that are recognised as equivalent to Offset Credits under the NETS.