

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

### Questions and Answers

<b>GENERAL</b>	
<p>1. What is the aim of the National Emissions Trading Scheme (NETS)?</p>	<p>The NETS could provide an affordable response to the threat of climate change and could keep the economy competitive in an internationally carbon constrained future.</p> <p>The NETS as set out in the Discussion Paper is put forward as a possible design for discussion and response by stakeholders.</p>
<p>2. Why are the States and Territories considering this issue, rather than the Commonwealth?</p>	<p>It is the clear preference of all stakeholders and the State and Territory Governments that the Commonwealth Government be involved in – or even lead - an emissions trading scheme.</p> <p>The States and Territory Governments support the efforts of the Commonwealth Government in research and development of new technologies. At the same time, State and Territory Governments consider there is merit in discussing the need for price signals to be in place to provide investor confidence and facilitate new investment in low emissions technology.</p> <p>The proposed design is one way in which a gradual and manageable transition in Australia’s energy infrastructure and industries can be achieved, to ensure that they are sustainable and competitive in a carbon-constrained future.</p>
<p>3. Why should Australia have an emissions trading scheme given that many other countries do not have such schemes, no international agreements have been made post 2012 and Australia has not ratified the Kyoto protocol?</p>	<p>Australia needs to position itself to compete in a world where effective international action against climate change is taking place. That is, Australia needs to be able to compete in a <i>carbon-constrained</i> world. It is in Australia’s national interest to promote international action to reduce greenhouse gas emissions. What action Australia takes domestically is a key element of its credibility in international negotiations.</p> <p>Investors need greater certainty on when and how the costs of carbon constraints are to be applied in the economy.</p> <p>A carefully designed emissions trading scheme can help Australia enhance its competitiveness. It can do that by minimising the costs of reducing emissions.</p>

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4. Why is the proposed starting date 2010 when not much new base load electricity generation capacity is required until around 2020?	2010 is suggested as the earliest date on which the scheme could commence. Australia will need significant new baseload power generation plant from late next decade onwards. Such plant has long planning and construction lead times. This means that policies must be in place to guide design and investment well before the new plant is constructed.
5. When will a final policy position paper be released?	A decision on release of a final policy position paper will be made by the State and Territory Governments, following consideration of the outcomes of the next phase of work on scheme design and stakeholder feedback on the proposed design contained in the Discussion Paper.  The next phase will involve more detailed design work and modelling, along with extensive stakeholder consultation.
6. How would auction revenue be divided among the States and Territories?	The division of auction revenue among States and Territories has not been decided at this stage. It will be considered as part of future work, and would take into account the differing impacts of the scheme. Nevertheless, it is proposed that once divided among jurisdictions, individual governments would be free to decide who should receive assistance and how this assistance should be provided.
7. How much revenue will go to the States and Territories? Is this just another revenue raising exercise by the States and Territories? Isn't this just a carbon tax?	Preliminary modelling has been undertaken to examine the potential implications of <i>indicative</i> scheme caps on the electricity sector and the broader Australian economy. The division of auction revenue among States and Territories has not been decided at this stage. It will be considered as part of future work, and would take into account the differing impacts of the scheme.

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7. (Continued)	Emissions trading is not a tax. A tax does not offer flexibility to business to cut emissions. Nor does it provide any certainty regarding the level of emissions reductions that will be achieved. By contrast, emissions trading provides a far more flexible and efficient approach to reducing emissions. Businesses can choose to cut their emissions or to acquire permits. Those businesses that can cut their emissions more cost-effectively than others can benefit by selling emissions permits.
8. How much information about company emissions will be made public?	<p>The proposed scheme design aims to dovetail with new national processes for emissions monitoring, reporting and verification that are currently being developed for consideration by the Council of Australian Governments later this year. More information on this process is available at <a href="http://www.ephc.gov.au">www.ephc.gov.au</a></p> <p>Public disclosure of company emissions is likely to match those in the new national reporting processes. However, additional disclosure may occur if cases of non-compliance are publicised once established.</p>
9. What will the penalty be for companies that have insufficient permits to cover their emissions?	A civil penalty is proposed that caps the cost of the scheme at an acceptable level but also encourages compliance. It is not proposed to include a make-good provision.
10. How will the trading markets work?	<p>Permits would initially be distributed to participants through a combination of administrative allocation and auctioning. Thereafter, participants may trade permits directly with each other, or they may buy or sell via a broker, bank or other market intermediary.</p> <p>The price would be a function of supply and demand as in any other free market. Governments would not run the market. Rather, the experience of the European Union Emissions Trading Scheme shows that market intermediaries would emerge that quote prices for permits, much like the way in which the Australian Stock Exchange facilitates share trading.</p>

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11. How will the ownership of permits be tracked?	An electronic registry that keeps track of the ownership of permits and offset credits would be established by the Scheme Regulator. Permits are not printed on paper but would exist only in an account of that registry. Therefore all participants of the National Emissions Trading Scheme would need to open an account in the registry with the Scheme Regulator.
12. Is this the same as water trading?	No. Water trading aims to allocate a physically scarce resource efficiently across different users. Markets tend to be regional, reflecting the nature of the resource. Emissions trading seeks to reduce greenhouse gas emissions by placing a limit (i.e. cap) on emissions and allowing liable parties to trade permits nationally to meet those limits at least cost.
13. When will the scheme start? When will it end?	<p>The Discussion Paper proposes that the National Emissions Trading Scheme could commence as early as 2010. At the commencement of the scheme a mixture of firm caps and a range of possible future caps (or ‘gateways’) would be provided for a 20 year period. These caps would be extended over time.</p> <p>A scheme end date has not been contemplated at this time. It is proposed that a general review of the scheme would be finalised by 2015 with the objective of maintaining and enhancing scheme effectiveness and efficiency.</p>
14. What are the processes for further consultation?	<p>Written comments on the possible design in the Discussion Paper close on Friday 22 December 2006. These may be sent by email to <a href="mailto:submissions@emissionstrading.net.au">submissions@emissionstrading.net.au</a> or posted to: National Emissions Trading Taskforce Secretariat, c/- The Cabinet Office, GPO Box 5341, Sydney NSW 2001.</p> <p>Stakeholder forums will be organised in capital cities, and the details made available on the NETT website: <a href="http://www.emissionstrading.net.au">www.emissionstrading.net.au</a></p>

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<b>COVERAGE</b>	
15. What consultation has been undertaken to date?	Extensive stakeholder consultation has been undertaken in developing the Discussion Paper. This consultation included the 2005 release of a background paper for comment, stakeholder forums, meetings with Stakeholder Roundtable Groups and a range of individual stakeholders.
16. What is the scope of the National Emissions Trading Scheme (NETS)?	<p>The proposed scope of the NETS is most of the ‘stationary energy’ sector as defined in the National Greenhouse Gas Inventory (NGGI), along with a small component of the ‘fugitive emissions’ reporting category.</p> <p>Stationary energy covers all emissions from fuel use, except fuel used by transport. A small subset of stationary energy is proposed for exclusion – emissions from petroleum refining, and emissions from mobile (non-transport) sources that are reported within the stationary energy category. These mobile sources include farm, forestry, fishing and mining equipment, lubricants and military fuel use.</p> <p>The fugitive emissions proposed for coverage are those from natural gas transmission and distribution networks.</p>
17. Why hasn’t transport been included?	State and Territory Governments determined in 2005 that the scheme would initially cover the stationary energy sector, but with scope to include additional sectors over time. The proposed design reflects this. See <a href="http://www.emissionstrading.net.au">www.emissionstrading.net.au</a>
18. Why isn’t air transport proposed for inclusion?	<p>State and Territory Governments determined in 2005 that the scheme would initially cover the stationary energy sector, but with scope to include additional sectors over time. The proposed design reflects this. See <a href="http://www.emissionstrading.net.au">www.emissionstrading.net.au</a></p> <p>Emissions from international air transport are not currently covered by the Kyoto Protocol. However, the European Commission is preparing a new directive to include air transport in its emissions trading scheme.</p>

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ENVIRONMENT	
19. Does this scheme give industry an incentive to reduce their greenhouse gas emissions?	Yes. The scheme will provide incentives for businesses to switch to low emissions technologies that are currently available, but require additional economic support. It could also stimulate investment in, and accelerate the deployment of, prospective technologies that are currently at the experimental and demonstration phase. By reducing emission, companies could reduce the cost of buying permits, or make money from selling them.
20. How much abatement will the scheme deliver?	No decisions have been taken on final emissions caps. The <i>indicative</i> scenarios modelled in the Discussion Paper involve cumulative reductions in Australian emissions of around 1,000 Mt to 1,300 Mt of CO <sub>2</sub> -e over the period 2010 to 2030, compared to business as usual.
21. Will the scheme drive RD&D and innovation?	Emissions trading could play a valuable complementary role to an effective RD&D programme. The carbon price from an emission trading scheme provides strong incentives for businesses to switch to lower emissions technologies that are currently available, but require additional economic support. For example, emissions trading would provide incentives for existing coal generators to increase their thermal efficiency and thereby reduce CO <sub>2</sub> emissions.  It could also stimulate investment in, and accelerate the deployment of carbon capture and storage and renewable energy technologies.

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### Questions and Answers

IMPACTS	
<p>22. What does the scheme mean for household energy bills?</p>	<p>A carefully designed scheme could ensure that impacts on household energy bills are modest. Preliminary modelling shows that additional average weekly expenditure on electricity could be as low as an additional \$0.59 per week for the typical household over the period 2010-2020, compared to business as usual. The relative increase varies across the States and Territories. This reflects both the variation in the relative increase in wholesale electricity prices and variations in the amount of electricity used by households across the jurisdictions. Further work will be done to assess the possible impacts on household energy bills.</p>
<p>23. What will the scheme mean for renewables?</p>	<p>The scheme would provide a significant boost for renewable energy. It is proposed that renewable energy generators would not be liable parties under the National Emissions Trading Scheme (NETS). To avoid double counting they are also not proposed to be included as eligible offsets projects. However, increased wholesale electricity prices, projected to result from the implementation of the NETS, would improve the viability of renewable energy projects. This may well complement the effectiveness of existing programs that are encouraging the take-up of renewable energy.</p>
<p>24. What will the scheme mean for energy efficiency?</p>	<p>The economics of energy efficiency projects would receive a boost from increases in electricity prices resulting from the National Emissions Trading Scheme (NETS). This is in addition to the assistance from the various energy efficiency programs that are being progressed by Australian governments.</p> <p>State &amp; Territory Governments will also continue to pursue targeted energy efficiency policies and measures. Improvements in energy efficiency help to offset the impacts on energy <i>costs</i> of an increase in energy <i>prices</i> (ie. energy costs = volume of energy consumed x energy price).</p>

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IMPACTS	
<p>25. Why do trade-exposed, energy-intensive industries get free permits? Won't this mean they will emit more?</p>	<p>Trade-exposed, energy-intensive industries are most vulnerable to the effects of introducing an emissions trading scheme. The purpose of the proposed free allocation to this sector is to offset the impact of the emissions trading scheme on energy prices, and thereby neutralise the effect of the scheme on international competitiveness of these industries. Free permit allocation would cease in the event that a firm were to close down its Australian production or overseas competitors were subject to equivalent emissions constraints.</p> <p>Tying the allocation of permits to output does not diminish the incentive for a firm to improve its energy efficiency and reduce emissions.</p> <p>The value of permits means that emitters will have an incentive to further reduce emission to sell excess permits in the trading market.</p>
<p>26. Why are generators getting free permits? Won't this mean they will emit more?</p>	<p>It is proposed that some permits would be allocated for free to those existing generators estimated to be significantly adversely affected by the scheme.</p> <p>It is proposed that the allocation of permits would not be tied to subsequent emissions levels. In this way, generators' incentives to minimise their emissions remain intact. For example, some generators might find it more profitable to sell their permits to a new entrant and reduce their output, or possibly to close down, rather than continue to operate in the same manner as before the emissions trading scheme was introduced. Since the cap is fixed the scheme provides certainty regarding the environmental outcome.</p> <p>The value of permits means that emitters will have an incentive to further reduce emission to sell excess permits in the trading market</p>

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<b>IMPACTS</b>	
27. What about new generators?	The Discussion Paper proposes that <i>new</i> generators should not be eligible to receive a free allocation of permits. This is because a new investor with knowledge of the scheme could build a plant that could operate optimally in the new environment.
28. How will this scheme affect energy prices? Will this scheme affect petrol prices?	<p>Attaching a cost to emissions will increase energy prices. Preliminary modelling suggests that a carefully designed scheme would keep overall costs lower than other ways of reducing greenhouse gas emissions.</p> <p>Importantly, industries most vulnerable to the effects of introducing an emissions trading scheme—trade-exposed, energy-intensive industries—can be successfully sheltered from the impacts of the scheme.</p> <p>Transport is excluded from the scheme coverage. Petrol prices therefore will not be directly affected by the proposed National Emissions Trading Scheme.</p>
29. What are the likely impacts on the economy?	The results of preliminary modelling show that GDP and consumption levels would continue to grow in line with ‘business-as-usual’, but with significant reductions in emissions occurring at the same time.
30. What does the scheme mean for the forestry sector?	The forestry sector is predicted to significantly benefit through the proposed National Emissions Trading Scheme (NETS). The actual benefit would depend on the extent to which the sector could create cost-competitive offset credits under the scheme.

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<b>IMPACTS</b>	
31. Who's going to benefit from the scheme?	<p>The community as a whole would benefit to the extent that the proposed scheme was able to reduce Australia's greenhouse gas emissions more smoothly and efficiently than alternative measures. Investors would benefit from a more certain long term policy environment. The proposed scheme is likely to directly benefit low emissions generators, offset creators (such as the forestry industry), and those who pursue energy efficiency projects.</p>
32. Who is going to be worse off under the scheme?	<p>The emissions trading scheme has been carefully designed to maintain strong economic growth while also reducing greenhouse gas emissions.</p> <p>The scheme has been designed to allocate permits for free to those that would be most adversely affected by the scheme - to existing electricity generators to compensate them for the estimated impact on profitability and to trade-exposed energy-intensive industries to offset the increase in energy prices.</p> <p>The remaining permits will be auctioned. This provides a source of revenue that can be used to offset the impacts of the scheme on other groups, which could include households, regions and small businesses.</p>
33. What will the compliance burden be on industries?	<p>Cost impacts of emissions monitoring and reporting under an emissions trading scheme are expected to be relatively low, as monitoring and reporting of greenhouse gases is expected to be introduced as a result of separate processes being developed at a national level. Cost savings are expected to occur through the streamlining of reporting requirements under those national processes, and these would offset the additional requirements for data quality and auditing that would be needed to underpin an emissions trading scheme.</p>
34. What does this scheme mean for nuclear power?	<p>Modelling to support the Discussion Paper has not contemplated nuclear power. A number of jurisdictions have legislation banning nuclear power.</p>

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<b>IMPACTS</b>	
35. What does this scheme mean for coal mining?	<p>The coal-fired electricity sector is projected to grow at a slower rate than business as usual in all scenarios modelled. Nevertheless, coal continues to be the dominant source of electricity, accounting for around 54% of electricity supplied in 2030 (compared with 75% under business as usual).</p> <p>Coal exports would not be affected by the proposed National Emissions Trading Scheme.</p>
36. What does this mean for the gas industry?	Output from gas-fired electricity generators would be expected to increase. This expansion is driven by permit prices, which make this sector increasingly competitive.
37. What modelling has been undertaken?	Preliminary modelling has been undertaken to examine the potential implications of <i>indicative</i> scheme caps on the electricity sector (eg wholesale and retail electricity prices) and the broader Australian economy (eg GDP/GSP).
38. What further modelling will be done?	The modelling work undertaken to date is informative, but only a first step towards understanding the impacts of key design choices of the emissions trading scheme, such as the scheme cap and coverage. Further modelling will be undertaken to inform decisions on a scheme design that best maintains Australia's economic prosperity and growth while making a meaningful environmental contribution. Stakeholder input is being sought on the best approach to future modelling.

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<b>OTHER SCHEMES</b>	
<p>39. What does the National Emissions Trading Scheme (NETS) mean for existing schemes (Mandatory Renewable Energy Target (MRET), Victorian Renewable Energy Target (VRET), Greenhouse Gas Abatement Scheme (GGAS), Qld 13% Gas Scheme)?</p>	<p>The NSW and ACT GGAS would overlap substantially with capped participants and offsets providers under the NETS. The NSW Government is considering means to prepare for the transition to a NETS and to facilitate an extension to GGAS in the event that agreement on the NETS is delayed.</p> <p>Given the proposed design of the NETS (that is, coverage for caps, eligibility of offsets), it would be possible for MRET, the Victorian Renewable Energy Target and the Queensland 13% Gas Scheme to operate in parallel with the scheme.</p>
<p>40. Why isn't the National Emissions Trading Scheme (NETS) replacing all existing schemes?</p>	<p>NETS can operate in parallel with some existing schemes without causing any problems of double counting (e.g. Qld 13% Gas Scheme). The schemes that would remain have different objectives which would not necessarily be met under a NETS alone.</p>
<p>41. What other similar trading schemes exist?</p>	<p>There are several existing and planned emissions trading schemes elsewhere in the world. The European Union (EU) has implemented a cap and trade scheme which started in January 2005. The scheme covers more than 11,000 energy-intensive installations across the 25 EU Member States, which represent close to half of Europe's emissions of CO<sub>2</sub>.</p> <p>Under the Kyoto Protocol industrial countries have agreed to cap their emissions and are able to trade these so called Assigned Amount Units (AAUs) with each other. However, since the first commitment period will start in 2008 no spot market trading in AAU has taken place so far. The Kyoto Protocol also allows for trade in certificates created under the Clean Development Mechanism and Joint Implementation. There is an active international market for these credits.</p>

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<b>OTHER SCHEMES</b>	
41. (Continued)	<p>The North-Eastern States of the United States are developing the Regional Greenhouse Gas Initiative, which will start in 2009. This will also be a cap and trade scheme.</p> <p>The United Kingdom has implemented a national trading scheme for the period 2002 to 2006. The scheme design is based on a baseline and credit approach.</p>
42. Why isn't the timing matched to the Kyoto Protocol compliance periods?	<p>The proposed scheme could commence as early as 2010. A start date at around this time may allow for a smooth transition to more stringent abatement in the future.</p> <p>Since Australia is on track to meet its Kyoto target, emissions reductions targets in the earliest years of the scheme could be modest.</p>
43. Isn't it risky to set up a scheme before we know what our obligations are under any new post-Kyoto international agreement?	<p>The proposed National Emissions Trading Scheme design would give governments the flexibility to respond to future international developments and thereby minimise impacts on the economy. It could help Australia and Australian businesses to be better prepared for climate change.</p> <p>In any event, there is a need to reduce the current uncertainty faced by investors in energy markets and among energy-intensive industries. Taking action in the near future would allow Australia to follow a smoother adjustment path to a carbon-constrained economy. Domestic action forms part of a persuasive international position on climate change.</p>

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<b>OTHER SCHEMES</b>	
44. Will this scheme force energy-intensive industries offshore?	No. It is proposed that trade-exposed, energy-intensive industries will be allocated free permits to offset the impact of the emissions trading scheme on energy prices. This will neutralise the effect of the scheme on international competitiveness of these industries.
45. What about linking the National Emissions Trading Scheme (NETS) with other existing schemes?	<p>The Discussion Paper acknowledges that bilateral linking <i>might</i> be desirable in the longer term but proposes that initially the principal objective of designing the NETS should be to establish a strong domestic market.</p> <p>However, allowing Australian companies to use the Clean Development Mechanism credits as offsets from the outset of the scheme (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.</p>
46. Is the proposed National Emissions Trading Scheme (NETS) the same as the European Union Emission Trading Scheme (EU ETS)?	<p>Both the NETS and the EU ETS are cap and trade schemes. However, the schemes have many different design features.</p> <p>The EU ETS has broad coverage (11,500 industrial plants, many with very small greenhouse gas emissions, across 25 Member Countries). By comparison, the proposed NETS would cover around 100 electricity generators with an installed capacity of greater than 30 MWe.</p> <p>In addition, the European Commission has acknowledged that a key lesson from the first trading period is that allocation plans and targets have been overly complex and have lacked transparency. For the NETS, it is proposed that permits be centrally allocated by the Scheme Regulator using transparent approaches. These approaches would be made available for public scrutiny well in advance of allocation actually occurring.</p>

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<b>OTHER SCHEMES</b>	
46. (Continued)	<p>Finally, the EU ETS provides a short period of certainty on coverage and allocation (2005-07), which has created uncertainty. By comparison, the proposed NETS includes a rolling 10 year period of firm annual caps and up-front, long-term decisions on the allocation of permits.</p> <p>In designing the NETS, consideration has been given to the experience of the EU ETS.</p>
47. Why should Australia introduce an emissions trading scheme when it hasn't worked in the EU?	<p>The EU ETS is work-in-progress. Energy price increases since the introduction of the EU ETS began operating are due more to other factors (eg. rising oil and gas prices) than to the introduction of a carbon market.</p> <p>In designing the NETS, consideration has been given to the experience of the EU ETS. A carefully designed emissions trading scheme can help Australia enhance its competitiveness. It can do that by minimising the costs of reducing emissions.</p> <p>It is in Australia's national interest to promote international action to reduce greenhouse gas emissions. What action Australia takes domestically is a key element of its credibility in international negotiations.</p>
48. Is this the same as the McKibbin Wilcoxon Blueprint?	<p>No. However, both approaches aim to provide credible incentives to cut emissions by issuing tradable emissions permits for a long time period. Also, both approaches give governments the flexibility to respond to future developments and thereby minimise impacts on the economy.</p>
49. How can we use credits from the Clean Development Mechanism (CDM) when we haven't ratified the Kyoto Protocol?	<p>This could be accomplished within the current rules of transactions under the Kyoto Protocol. The Scheme Regulator would establish an account in the national registry of, say, Ireland or the UK. CDM credits to be used in the Australian scheme would be transferred to the Scheme Regulator's account so that they could be 'surrendered' into the cancellation account of that registry. Corresponding credits would then be created in appropriate accounts in the Australian registry, essentially transferring the 'recognition' of the offset credits from one scheme to another.</p>

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<b>OTHER SCHEMES</b>	
50. How does this relate to the Asia Pacific Partnership (AP6)?	Although an emissions trading scheme is no substitute for an effective research, development and demonstration (RD&D) program, it is a valuable complement to it. Once developed, the carbon price from an emission trading scheme can help ensure that new technologies, encouraged by programs such as AP6, are deployed.
51. How does this relate to other Government greenhouse policies?	<p>Emissions trading could form an important part of the greenhouse response. However, applying a price to greenhouse gas emissions is only part of the story. Major changes in technologies and behaviour are required across the economy. There are many non-price barriers to cutting emissions, as well as the need for a significant research and development effort. Australian Governments are implementing a wide range of complementary measures to reduce emissions across the economy (e.g. diverse energy efficiency programmes).</p> <p>Existing greenhouse policies such as energy efficiency are important in the lead up to the possible introduction of the scheme because they will help to minimise any impacts from the introduction of a carbon market.</p>