

Trade in International Units in Australia's Climate Policy: Higher Ambition at Lower Cost

Greenhouse gas emissions impact the climate at a global level. The climate is agnostic to the geographic source or sink of greenhouse gas emissions and therefore there is a need for global coordinated action if abatement is to be effective. Allowing the trade in and surrender of credible international emissions units provides governments and businesses flexibility to capture a wider range of mitigation opportunities to keep domestic compliance costs low. The recently concluded Paris Agreement sets out a new framework for the trade in international emissions units with the detailed rules to be negotiated. This paper is intended to assist the Australian Government in developing its position to take into these negotiations and in refining its domestic policy settings.

Current Policy Setting

Australia's climate policy has been in constant evolution in the last few years. The proposal to phase in an Emissions Trading System (ETS) was repealed in 2014. The government instead decided to adopt the Direct Action Plan, which is structured around the Emissions Reduction Fund (ERF), a government-funded offset purchase programme, and the Safeguard Mechanism, a baseline-and-offset system that covers the emissions from selected large emitters. Under the Safeguard Mechanism, facilities exceeding their baseline need to purchase Australian Carbon Credit Units (ACCUs) generated by the ERF to cover for the excess emissions. The ERF and the Safeguard Mechanism will be reviewed in mid-2017 and therefore, their form may change over time.

Taking a long-term outlook, Australia has committed to reduce greenhouse gas emissions by 26 to 28% below 2005 levels by 2030, as part of its [Intended Nationally Determined Contribution](#) (INDC) towards the Paris Agreement. Such a commitment is challenging and requires an economy-wide effort to reduce emissions throughout Australia's economy. Nevertheless, a number of options are available to policy makers to ensure that the emissions reduction goal is achieved at the least cost and in the most cost-effective way.

The Post-Paris World

In December 2015, at COP21 in Paris, world leaders reached an agreement to limit global warming to well below 2°C. The Paris Agreement, once operational, will represent the main international framework to guide climate action for decades to come. In the run up to COP21, countries were encouraged to put forward their **Intended Nationally Determined Contributions (INDCs)**. An INDC can be seen as a pledge outlining the level of commitment each government intends to make towards the overall goal, and the actions it will undertake to achieve this target.

To date, **189 countries have submitted their INDCs**, with more than 90 stating that the level of commitment they are putting forward is conditional upon having **access to international carbon markets**. The UNFCCC's INDC [Synthesis Report](#), released on May 2016, also highlights that **over half of the INDCs submitted to date plan to use or are considering the use of market mechanisms**.

The high level of interest in international carbon markets and in international units is easily explained by the fact that these instruments represent a cost effective way to achieve emissions reductions. Access to an **international carbon market can enable countries to put forward stronger commitments**, going beyond their domestic capabilities. Some INDCs specify that in addition to their domestic contributions, an additional level of reductions could be achieved by having access to market-based mechanisms or international market linkages.

Article 6 of the Paris Agreement contains the key market provisions that are expected, once implemented, to be the guiding framework for international carbon market action going forward. Article 6 outlines provisions for:

1. **Cooperative approaches** through “internationally transferred mitigation outcomes” (paragraph 2);
2. Rules for **carbon market accounting**, particularly avoidance of double-counting (paragraph 2 & 5);
3. **Sustainable development & mitigation crediting mechanism** (paragraph 4).

IETA has recently released “[A vision for the market provisions of the Paris Agreement](#)”, a paper detailing how the market provisions of the Paris Agreement could be implemented to create an effective international framework for carbon markets. These market provisions have the potential of helping countries achieving their targets in the most cost-effective way, and to unlock opportunities to go beyond the original commitments. **It is therefore important for countries to actively engage in the implementation process of the Paris Agreement’s Article 6 and to align their domestic climate policies with the emerging international framework.**

Why International Units?

As outlined above, Australia’s long-term emissions reduction target requires a significant, economy-wide abatement effort. Addressing climate change and reducing emissions to the degree necessary will have a cost, and such cost poses a challenge as it could potentially impact on wealth, prosperity and quality of life. It is an absolute imperative therefore that ways are found to reduce emissions at the lowest possible cost, as to do otherwise will come at a penalty to the economic and personal prosperity. For many industrialised economies, such as Australia, that already have a relatively efficient industrial and energy sectors, the ambitious emissions reductions commitment required to meet the Paris Agreement’s long-term goal could result in significant costs for society, as domestic abatement options are likely to be costly. This is especially true for countries that are fully industrialised and have high carbon abatement costs and for countries whose emissions originate in sectors with limited abatement opportunities.

At the same time, greenhouse gas emissions impact the climate at a global level and the climate is agnostic to the geographic source or sink of greenhouse gas emissions. **Therefore, the use of international units is an option available to policymakers to maintain an ambitious long-term emissions reduction target while lowering abatement costs at the same time. Accessing international emission units could allow Australia to meet its target in a cost-effective way.**

The ability to surrender emissions units generated in another jurisdiction, by allowing emissions reduction to take place where it is cheapest can lower compliance costs to business as well as allow achieving Australia’s overall reduction goals in a cost-efficient way. Moreover, as a transfer of emissions reduction units corresponds to a transfer of finance and investments, the use of international units has the potential of opening up new markets and new business lines for Australian businesses. For example, Australian farmers could be able to sell ACCUs to liable entities in other systems. Taking a long-term perspective, the trade and surrender of international units can be seen as a first form of linking climate efforts between two or more countries, as it can broaden the scope of domestic climate action by allowing the flow of units between different systems. The use of international units brings a number of benefits, further elaborated below.

Cost-effectiveness

- The ability to surrender an emissions unit from another jurisdiction can **help lower compliance costs**. Widening the pool of abatement options beyond Australia’s borders can lower the overall costs of abatement and help meeting the environmental objective at the lowest cost. By allowing flows of emissions units in and out of the system, according to where mitigation is cheapest, the **long-term emission reduction targets for both Australia and international partners will be able to be met by all sectors cost-effectively**.
- As emissions reduction targets grow more stringent over time, **Australian businesses will need access to international markets to reduce emissions cost-effectively** and maintain international competitiveness. As costs of abatement differ from country to country over time, **access to international market mechanisms**

outside Australia can **reduce overall costs to industry and governments alike. This would also help creating a level-playing field by aligning the costs for Australian business with those of international competitors.**

- **Flexibility** in the system **allows participants to make strategic choices** about their route to compliance as well as ensuring their abatement options for global greenhouse gases are more efficiently and cost-effectively abated using modern techniques and technologies.

International Cooperation and Global Partnerships

- International efforts and cooperation in climate change mitigation are needed to meet the Paris Agreement's long-term 2°C goal. **Focusing emission reductions only domestically will not be sufficient to achieve the necessary emission reductions needed globally.**
- Australia would set a precedent and a good example for other countries and regions to work towards viable international markets that would create demand for international units from other jurisdictions. **Providing access to international units will incentivise advanced, emerging, and developing economies alike to meet climate mitigation goals using market mechanisms**, improving the cost-effectiveness and quality of their systems. Governments hosting projects for which credits will be issued will see the benefits of market-based measures to reduce emissions.
- **The use of the CDM expanded international cooperation with many developing countries and prompted the growth of expertise within their business communities.** It also created export opportunities for technology transfer. These lessons learnt should be looked at when considering the use of international units post-2020.
- Emissions units are important not only in environmental terms, but also in **providing improved prospects for linking of ETSs in the future.** They provide a safety valve for each system and each system can implement the filters it feels are necessary for its domestic ETS, according to predefined criteria.

What types of international units?

International emissions units eligible for compliance in Australia should include internationally-recognised emissions reduction credits as well as emissions allowances issued under other ETSs. International credits typically include Certified Emission Reduction (CER) credits generated by Clean Development Mechanism (CDM), Reducing Emissions from Deforestation and Degradation (REDD+) credits and others. Moreover, **Australia's climate policy framework should also contain provisions for the inclusion, in the post-2020 period, of international credits categories established under the framework of the Paris Agreement.** Articles 5 and 6 of the Paris Agreement pave the way for the expansion of a REDD+ framework and for the development of a new market-based mechanism.

IETA's initial views on the future crediting mechanism under Article 6 of the Paris Agreement are outlined in the aforementioned "[A vision for the market provisions of the Paris Agreement](#)". Particular attention should also be focused on REDD+ credits, as addressing deforestation is essential to avoid climate change. IETA views REDD+ as a key new mechanism as it has the potential to provide crucial financing to emissions reductions activities at an impactful scale. REDD+ credits can help combating deforestation, and Article 5 of the Paris Agreement paves the way for the establishment of a REDD+ framework at the UN level.

Therefore, when exploring the use of international units in Australia, several unit types should be considered, both existing and under development, as they allow having diversified sources of abatement opportunities and because frameworks that are currently being developed are likely to represent an important sources of international units in the near future. Furthermore, IETA recommends the use of units that meet the criteria and principles outlined below.

How to use International Units

IETA recognises that **the use of international units must operate within well-defined parameters**. Allowing an uncontrolled flow of units is not a sustainable solution and we would therefore recommend clear and strict criteria that would define the quality of international units and rules for their use.

The role of international units should satisfy the following principles:

- **Integrity:** International units should represent real, permanent and additional reductions, and be subject to robust monitoring, reporting and verification (MRV). It is therefore essential to ensure common and consistent MRV processes. One tonne of reductions located outside Australia should equal at least one tonne of reductions within Australia. Clear quality criteria need to be agreed at the UN level from the outset, to allow individual and sectoral projects to develop once they meet minimum criteria set by the UNFCCC.
- **Regulatory stability:** The extent to which international units should be allowed (volume and type) should be defined as clearly as possible. This offers market participants visibility on what to expect in terms of market dynamics, and it helps to avoid a sudden inflow or outflow of units when rules get modified. Moreover, property rights on the emissions units must be ensured to market participants, to prevent regulatory uncertainty and economic losses.
- **Compliance with the UNFCCC framework:** International units should comply with the evolving framework established by Article 6 of the Paris Agreement.

Moreover, criteria for the type of international units should include the following:

- **Net mitigation contribution:** The extent to which a project counts against a host country's efforts to reducing their domestic emissions should be clearly established, to assure that there is no double counting. Net mitigation could be set by project type and/or by country type.
- **Clear additionality:** Units should meet a clear additionality standard set by determining an appropriate sectoral benchmark for the country or region. Projects with clean technologies that abate significant levels of GHG emissions should flourish as a result.
- **Sustainable development:** Units should, in addition to contributing to a net mitigation of greenhouse gas emissions, support sustainable development, as outlined by the Paris Agreement's Article 6.
- **Project neutrality:** Project size should not be a criterion for the eligibility of units, in order not to favor small projects over large projects and vice versa.
- **Credibility:** UN-issued credits could be recognised, to ensure that qualitative criteria are guaranteed.
- **Country type:** The partner country should be making proactive efforts to reduce its emissions/emissions intensity.

Conclusions and recommendations

As articulated above, allowing the use of international units enables governments and businesses to capture a wider range of mitigation opportunities to keep costs down. In Australia's current policy setting, the use of international units should be considered as an option for compliance under the Safeguard Mechanism. Liable entities under the Safeguard Mechanism should be allowed to surrender credible international emissions units against their facility emissions, following the principles outlined above. Moreover, the export of ACCUs should also be enabled where firms wish to surrender those units to satisfy a liability in different systems. The use of international units should not be limited to these options, but other ways to bring external mitigation opportunities under the scope of Australia's climate action should be explored.

Going forward, it is also crucial to deeply engage in the international discussions on Article 6 of the Paris Agreement to put in place a transparent, fungible international market and trade in emissions units. If Australia is serious

about its emissions reduction commitment, it should consider international units and access to international markets as a cost effective way to meet its objectives. Furthermore, IETA believes that allowing the use of international units is in Australia's long-term interest. It is a classic "win-win" strategy, since it encourages global participation and offers a cost-effective compliance option for regulated companies.