ETS Linking: Garnaut Review views

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Introduction

- Linking internationally is a form of shared sovereignty, which will imply some loss of control over aspects of mitigation policy, but also potential benefits in terms of reduced costs, and increased flexibility. Australia will be a small player in comparison to the EU or emerging US carbon markets or any national market that developed in China. It would therefore be more or less a price taker if linking fully to those markets.
- Although to date international linking has been limited in scope, it is likely to grow in the future, as more developed countries establish ETSs, and as developing countries become more important players in global climate change mitigation efforts.

Linking taxonomy

- Links with other emissions markets v offset markets?
- Direct v indirect links
- Unilateral v two-way linking
- Government v private trading
- Limited v unlimited trading
- Simple linking v deep integration

Linking pros and cons

- Pros: linking reduces cost, increases flexibility, provides financing, enables entitlements to be agreed on, delivers a level-playing field
- Cons: Many consider international linking to be the worst feature of an ETS.

Recommendations re individual markets

- No direct link with DCM, except perhaps from least developed countries
- NZ: linking or deeper integration
- PNG and Indonesia: the regional market approach
- EU: explore the possibility of linking; LUCF may be a bar
- Others: explore as opportunities arise

Other recommendations

- Deep integration with NZ and PNG; linking with other markets based on repeated assessments of quality.
- Allow trading by governments and market partcipants: governments only if no domestic ETS
- Limit international purchases; define limits at the same time as targets (higher limits, higher targets).
- Governance:
  - Government: define limits, targets, strategic parameters.
  - Independent authority: certify individual markets as suitable for linking.

Bottom line

- **International Trade:** The costs of abatement can potentially be substantially reduced, and therefore more ambitious targets achieved, by international trade in permits. However, linking with an economy that has a flawed domestic mitigation system will result in the import of those flaws. Variations in the quality of mitigation arrangements across countries mean that the decision to link with particular markets is a matter for fine judgement, but ultimately global mitigation will only be successful if countries can trade in emission permits. Opportunities for international linkage of the Australian ETS should be sought in a judicious and calibrated manner.