
Linking Emissions Trading Schemes

Synthesis Report -Executive Summary

Authors:

Andreas Tuerk, Joanneum Research

Wolfgang Sterk, Wuppertal Institute for Climate, Environment and Energy

Erik Haites, Margaree Consultants

Michael Mehling, Ecologic Institute

Christian Flachsland, Potsdam Institute for Climate Impact Research (PIK)

Hitomi Kimura, Institute for Global Environmental Strategies (IGES)

Regina Betz, University of New South Wales

Frank Jotzo, Australian National University

May 2009

Climate Strategies aims to assist government in solving the collective action problem of climate change. It is a not for profit membership organization, limited by guarantee. Funders include international governments and foundations. All our research is published in the public domain.



www.climatestrategies.org



Climate Strategies aims to assist governments in solving the collective action problem of climate change. It connects leading applied research on international climate change issues to the policy process and to public debate, raising the quality and coherence of advice provided on policy formation.

We convene international groups of experts to provide rigorous, fact-based and independent assessment on international climate change policy. To effectively communicate insights into climate change policy, Climate Strategies works with decision-makers in government and business, particularly, but not restricted to, the countries of the European Union and EU institutions.

Contact Details

UK - Managing Director: Jon Price (jon.price@climatestrategies.org)

US - Research Director: Thomas L. Brewer

Secretariat: Climate Strategies c/o University of Cambridge
13-14 Trumpington Street Cambridge, CB2 1QA, UK
+44 (0) 1223 748812
www.climatestrategies.org

Climate Strategies is grateful for funding from The Carbon Trust (founding supporter); governments of Australia, ADEME (France), MFA (Norway), Swedish Energy Agency, Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ, Germany), DEFRA, OCC, DFID (UK); and foundations, the Center for International Public Policy Studies (CIPPS, Japan) and European Climate Foundation (ECF).

All views expressed are solely those of the authors. Any errors and omissions are the sole responsibility of the authors.

Executive Summary

The aim of this study is to: (1) evaluate the feasibility of different forms of linking, with an emphasis on variations among bilateral and unilateral forms of linking; (2) assess the barriers and the time frames for implementing different forms of linkages; (3) determine the legal and institutional requirements for successful trading across jurisdictions; and (4) ascertain the roles for linking in post-2012 climate architectures.

The paper concludes that an OECD-wide company-level carbon market by 2015 is a highly ambitious goal. It is more likely that 2015 will be at the beginning of a period for establishing the first links between trading systems in different OECD countries. Candidates for earlier full bilateral links are systems in countries or regions that are close trading partners and already have a history of policy coordination.

A growing number of countries are integrating cap-and-trade systems into their national climate policies. The European Emissions Trading Scheme (EU ETS), is the frontrunner in this development. In addition, a number of other national and sub-national emissions trading systems are emerging around the world. In the United States, in particular, initiatives have been launched at the state level: the Regional Greenhouse Gas Initiative (RGGI) on the East Coast, the Western Climate Initiative (WCI) between states on the West Coast and other US states and Canadian provinces, and the Midwestern Greenhouse Gas Accord in the central part of the US. In addition, several legislative proposals for a federal system are currently under discussion in the US Congress. In Australia, detailed provisions for a scheme starting in 2010 have been tabled, and such schemes are also emerging in New Zealand and Japan.

The European Commission sees the EU ETS as nucleus for creating a global carbon market. It envisions an OECD wide Carbon market by 2015, and a priority for the EU is to establish a transatlantic link between the EU ETS and a federal US scheme. A combined EU-US market would cover the larger part of OECD emissions, and could thus constitute the backbone for the future international emissions trading regime. If the EU and U.S. find common ground on key design elements, this would probably exert significant influence on the other, much smaller-sized OECD trading systems to align their designs accordingly and to join the linked market.

In most schemes assessed in this study, however, full bilateral linking is not a short-term priority, and its benefits will be weighed against the costs of sacrificing other objectives, in particular control over domestic CO₂ price levels. Accordingly, linking has to be considered as a trade-off with other policy objectives. The EU for example clearly prioritizes the achievement of a defined reduction target, and thus will tolerate a relative increase in allowance prices to achieve this aim. In many other regions, there is greater sensitivity regarding the level of future carbon prices, and especially with a view to high prices in the near term. Other design features that may pose a significant barrier to linking in the short term include offset provisions (such as the eligibility of offsets) and intensity targets.

When discussing future linkages of emissions trading systems, it is important to be clear about assumptions regarding the policy scenario in which these occur. A distinction is necessary as to whether there will be a Kyoto-type successor agreement or not. Some of the potential barriers to linking cap-and-trade schemes, such as significantly divergent MRV provisions, will be easier to overcome with the adoption of a Kyoto successor treaty. More importantly, the comparability of targets will have been resolved through an international consensus-based burden sharing determination. However, regional carbon markets can be linked even in the absence of a Kyoto successor framework, enabling pioneers to cooperate in climate policy and keep up political momentum. It is also possible to link domestic carbon markets in the context of a Kyoto-II system. In this case, governments devolve trading activity to the level of companies, and trade only on behalf of sectors not covered by domestic ETS.

With negotiations on a global climate regime often threatened by diplomatic stalemate, linking provides a fallback option to the top-down international regime by offering a complementary bottom-up process through which national and regional emissions trading systems become increasingly integrated to eventually form a global carbon market. On its own, this process would not allow for negotiation of a global burden-sharing regime, nor would it result in the broad and instantaneous coverage of global emissions expected from an international Kyoto-II framework (unless a significant number of major emitters, such as the US, the European Union, China, Russia and others agree to form a joint carbon market outside of the UNFCCC arena).

Even if full bilateral links are unlikely to be implemented in the short term, most emissions trading systems will establish unilateral links to international offset mechanisms, such as the CDM or new crediting mechanisms under a Kyoto successor agreement. Indirect links among trading systems are also likely to play a prominent role under any of the expected scenarios. Indirect links could emerge by acceptance of CDM or new types of credits in all trading systems, and would lead to a complete or incomplete convergence of allowance prices, depending on the size of price differentials and the supply of CDM or other credits. The probability of price convergence increases with the available amount of credits and the relaxation of import restrictions on their use in cap-and-trade systems. Although overall the study shows that linking of emissions trading systems is likely to be some years away in terms of practical implementation, linking nevertheless merits careful attention as an important option in the future international climate regime.

TABLE OF CONTENTS

1	CONTEXT AND AIMS OF THE STUDY	1
2	FORMS, RATIONALE AND IMPLICATIONS OF LINKING	2
2.1	FORMS OF LINKS	2
2.2	IMPLICATIONS OF LINKING.....	4
2.3	RATIONALE FOR LINKING AND TRADE OFFS	5
3	OVERVIEW OF EXISTING AND EMERGING EMISSIONS TRADING SCHEMES	7
4	CASE STUDIES	10
4.1	LINKING NORTH AMERICAN SCHEMES	10
4.1.1	<i>Linking Scenarios for the United States</i>	10
4.1.2	<i>Linking Scenarios for Canada</i>	11
4.2	LINKING US SCHEMES WITH THE EU-ETS.....	13
4.3	LINKING THE AUSTRALIAN EMISSIONS TRADING SCHEME	16
4.4	LINKING FROM A NEW ZEALAND VIEW.....	20
4.5	LINKING JAPANESE SCHEMES	21
5	ASSESSMENT OF BARRIERS TO BILATERAL LINKING	25
5.1	ASSESSMENT OF BARRIERS BASED ON THE CASE STUDIES	25
5.2	BARRIERS OF LINKING THE EU-ETS TO EMERGING SCHEMES	28
5.3	THE ROLE OF OFFSETS IN LINKING TRADING SCHEMES	30
5.4	DESIRABILITY TO LINK FROM THE VIEW OF EMERGING SCHEMES.....	33
6	IMPLEMENTING A MARKET LINKAGE: ENSURING COMPLIANCE WITH THE REGULATORY FRAMEWORK	35
6.1	LINKING AND THE LEGAL SYSTEM	35
6.2	LEGAL NATURE OF EMISSIONS TRADING LINKAGES	36
6.3	CONSISTENCY WITH RELEVANT NORMS AND PRINCIPLES	37
6.4	CONSISTENCY WITH INTERNATIONAL, REGIONAL AND DOMESTIC LAW	38
7	THE ROLE OF LINKING IN A FUTURE CLIMATE AGREEMENT	43
7.1	THE ROLE OF LINKING IN DIFFERENT SCENARIOS FOR A FUTURE GLOBAL CLIMATE ARCHITECTURE	43
7.2	CASE STUDY: LINKING TO AVIATION/MARITIME COMMITMENTS.....	45
8	CONCLUSIONS	47
9	ANNEX I EXISTING AND PROPOSED EMISSIONS TRADING SCHEMES IN NORTH AMERICA	49
10	REFERENCES	55

LIST OF FIGURES AND TABLES

<i>Figure 1: Direct and indirect linking</i>	3
<i>Figure 2: Price convergence when cap-and-trade systems are linked indirectly via credits</i>	4
<i>Figure 3: Existing and emerging emissions trading schemes</i>	7
<i>Figure 4: Timelines for CPRS; Source: White Paper Road Show Presentation, 2008</i>	19
<i>Figure 5: Timeline for a future Japanese ETS</i>	24
<i>Table 1: Overview of design features of different ETS</i>	9
<i>Table 2: Possible Barriers of linking the EU-ETS to emerging schemes</i>	29
<i>Table 3: Comparison of offset provision in selected schemes</i>	31

The full synthesis report 'Linking Emissions Trading Schemes' is available to download from <http://www.climatestrategies.org/our-research/category/49/148.html>. For further information please visit the Climate Strategies website www.climatestrategies.org