



AUSTRALIAN  
AUTOMOBILE  
ASSOCIATION

# ON THE ROAD TO greener motoring

## EMISSIONS TRADING\*

### Background

The Federal Government is establishing an emissions trading scheme as part of an effective framework for meeting the climate change challenge. It has stated that a national emissions trading scheme would start no later than 2010 with the detailed design finalised by the end of 2008.

The Government has outlined five tests for an emissions trading scheme (ETS).<sup>1</sup> An effective emissions trading scheme must:

- be a cap and trade scheme to be internationally consistent;
- effectively reduce emissions;
- be economically responsible;
- be fair; and
- recognise the need to act now

### Overview

An emissions trading system places a price on greenhouse gas emissions by creating a scarcity in the right to make emissions and achieves abatement at the lowest possible cost by allowing trading of those rights.

This is commonly achieved by employing a 'cap and trade' approach whereby the government sets a limit on emissions which is less than 'business as usual' (ie sets a 'cap') and issues tradable emissions permits up to this limit. Governments can allocate permits by auctioning, grandfathering, benchmarking, allocating to meet specific equity objectives, or any combination of these options. Each permit provides a legal right to emit a specified quantity of greenhouse gas (usually one tonne of CO<sub>2</sub>-e). Entities covered by the system are required to acquit sufficient permits to cover their greenhouse gas emissions usually on an annual basis.

Permits are tradable to allow market forces to find the least costly ways of reducing emissions. Entities with the ability to reduce emissions at lowest cost have the incentive to reduce emissions and sell excess permits until the cost of reducing their emissions equals the market price of the permits. Entities can reduce emissions by reducing output, improving efficiencies and adopting emissions reduction practices and technologies.

Other entities may continue to emit (or even increase emissions) but must buy permits on the market, and will do so up to the point where the cost of purchasing a permit exceeds the cost of undertaking their own abatement activities. Thus, emitters with the greatest scope to embrace less emission intensive activities or production techniques make a bigger contribution to the abatement task than those whose abatement options are more costly. Equalising the costs of abatement across sources in this way minimises the total costs of abatement.

Carbon credits or carbon offsets can be generated by investing in carbon sink activities (such as planting trees) or by funding alternative energy sources. It is possible to incorporate these types of credits into emissions trading systems so that they can be traded and eventually acquitted, like permits, to cover emissions. This provides the 'credits' with their value.

### Permit acquittal — upstream or downstream

In principle, it would be preferable to make emitters the acquittal point for emissions trading permits so they can take the necessary action to reduce emissions. This is fairly obvious with some sectors such as emissions from electricity generation. However, in other activities — for example, emissions from transport — the sheer number and diversity of emission sources can make comprehensive emission coverage difficult and costly to achieve in practice. Apart

<sup>1</sup> [www.greenhouse.gov.au/emissionstrading/index.html](http://www.greenhouse.gov.au/emissionstrading/index.html)

