

Question 3. International Linkage

Submitter's Name/Affiliation: Eileen Claussen/Pew Center on Global Climate Change

Should a U.S. system be designed to eventually allow for trading with other greenhouse gas cap-and-trade systems being put in place around the world, such as the Canadian Large Final Emitter system or the European Union emissions trading system?

Clarifying Question 3a:

- Do the potential benefits of leaving the door open to linkage outweigh the potential difficulties?

Pew Center Response

Yes. The ability to link to other programs is critical in order to minimize mitigation and transaction costs, and to harmonize obligations under various systems. Companies whose obligations differ in the many nations in which they operate will have a much harder time complying with the requirements. For this reason it is crucial not only to link programs, but also to minimize the differences between relevant aspects of the programs as they are developed.

This position is corroborated by the extensive and ongoing discussions the Pew Center has had with member companies of the Business Environmental Leadership Council (BELC) and other domestic and international corporations about U.S. and international greenhouse gas (GHG) markets. Those that have expressed an opinion unanimously support designing U.S. cap and trade to allow for linkage to other national and regional trading systems. They cite several reasons.

- Most note that a well-functioning global trading market is perhaps the most critical mechanism for minimizing the long-term costs of GHG reductions for firms and society as a whole.
- Among cost-containment approaches, the linking of global GHG markets is among the least distortionary.
- Generally, larger trading volume and greater liquidity of GHG allowances will result in clearer, more stable prices. More stable prices will allow firms to project future prices more accurately and provide the certainty to plan and invest appropriately for the future (for example, in breakthrough technologies).
- Globalizing GHG markets supports the goal of encouraging all countries, including China and India, to participate in making real and verifiable reductions. (Companies note that offsets originating in large emitter developing countries will be among the lowest cost reductions and can be combined with export opportunities for U.S. firms.)

Note that the Northeast Regional Greenhouse Gas Initiative (RGGI) will accept EU and Clean Development Mechanism (CDM) allowances if certain price triggers are reached, but that under the Kyoto Protocol the EU can not accept RGGI allowances because the United States is

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not a party to Kyoto. RGGI analyses indicate that international agreements that enable two-way linkages would be economically beneficial.

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Clarifying Question 3b:

- If linkage is desirable, what would be the process for deciding whether and how to link to systems in other countries?

Pew Center Response

In order to link a U.S. program with other systems, reductions would have to be considered real and verifiable by the respective systems. Deciding whether to link would involve evaluating the inventory, methodologies, monitoring protocols and compliance mechanisms of the other systems, and as well as the design of these programs to make sure that the environmental effect of a given reduction is roughly equivalent across the two programs. In addition, care should be taken to design a U.S. program that other countries will be interested in linking with. In particular, mechanisms that alter the environmental integrity of the program (e.g., a low safety valve) would make reductions in one program not necessarily equivalent to reductions in another, jeopardizing the ability to link the two.

Federal legislation will need to address the state and regional GHG cap-and-trade programs now under development, some of which may be linked to each other and to other countries. As with any area of federal policy in which the states have taken the lead, Congress will have to decide on the extent to which the federal program will defer to pre-existing state programs, for example, governing allowance allocation.

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Clarifying Question 3c:

- What sort of institutions or coordination would be required between linked systems?

Pew Center Response

Because the validity and verifiability of reductions is critical for trading, measuring, monitoring, and compliance mechanisms would need to be comparable. While this may or may not require a central overseeing body, a shared platform on which to carry out the trades – such as an agreement to use a common monitoring and reporting protocol – would be required.

While elements within each country differ, Kyoto signatory countries, including the EU, Canada and Japan, have trading systems that are inherently linked by means of the treaty requirements. Requirements stipulate that each country needs to develop a consistent national system for estimating emissions and removals of GHGs by their common definition of trading units – Assigned Annual Units (AAUs), Joint Implementation (JI) credits and Clean Development Mechanism (CDM) credits – and by the requirement that an international transaction log (ITL) be established. This shared platform will enable the tracking and the issuance of credits, cancellation, retirement and carry-over to the commitment periods following 2012. In essence, Kyoto parties are linked because they share common definitions, common requirements and a common platform for trading.