

KEY LESSONS

This research paper draws on experience from domestic and international baseline and credit schemes to provide lessons for the development of the Emissions Reduction Fund (ERF). It focuses on three key design issues—coverage and uptake, additionality and baseline setting.

Baseline and credit schemes involve a degree of unavoidable complexity—they require rules for participation and crediting, approval processes for projects, and rigorous reporting and auditing. The lessons identified here can help Australia implement a more effective and efficient scheme.

COVERAGE AND UPTAKE

The government has stated the primary objective of the ERF is to achieve lowest cost emissions reductions. It is yet to determine which activities will be eligible for crediting (that is, eligible for funding for emissions reductions), and which facilities will be subject to the safeguard (penalty) mechanism. Experience in other schemes suggests:

- Broad coverage provides access to the widest range of low-cost opportunities, but in practice most emissions reductions are likely to arise from the energy and industrial sectors.
 - The bulk of emissions reductions in other schemes come from large-scale, low-cost projects, and from activities with established or readily available technologies and easy-to-establish baselines.
- Excluding activities that are already subject to other policy measures would avoid double-counting and improve the cost-effectiveness of the scheme.
- It will take time for the ERF to achieve large-scale emissions reductions.
 - Early emissions reductions are likely to be from well-established technologies and activities, and pre-existing projects that transition into the scheme (for example, existing Carbon Farming Initiative projects).
- Baseline and credit schemes do not suit all emissions reduction opportunities. The ERF is likely to be most effective as part of a broader suite of policy measures.

ADDITIONALITY

The government has stated that the ERF will purchase emissions reductions that make a real and additional contribution to meeting Australia's target. As a result, the ERF needs to determine the 'additionality' of activities. Other schemes use a wide range of approaches and experience suggests:

- Additionality tests are important—they help exclude activities from the crediting mechanism that would have occurred anyway.
 - Crediting non-additional activity would crowd out real emissions reductions, reducing the cost-effectiveness of the scheme and making Australia's target more difficult to achieve.

- Additionality tests can be resource-intensive and administratively time-consuming.
 - There are trade-offs between the rigour of additionality tests and costs for scheme participants and administrators.
 - The additionality of an activity needs to be periodically reviewed. Once an activity is no longer additional, it should no longer receive funding under the ERF.
- Both project-specific and more standardised additionality tests could play a role for the ERF.
 - Regulatory additionality is a common and relatively straightforward test to screen out non-additional activities, but is not sufficient on its own.
 - Pre-existing projects are generally not additional. Projects established in response to the carbon price could be additional but only if they would cease without an ongoing incentive.
 - Standardised tests, such as common practice tests, may reduce costs for scheme participants but can risk crediting non-additional emissions reductions. These approaches are more appropriate for homogenous activities where participants have similar investment incentives, have similar access to capital and use similar technologies.
 - Project-specific additionality tests, such as financial and barrier analysis, may be appropriate for large one-off projects for which standardised tests are not well suited.
- The ERF can assess additionality in parallel with baseline setting (by removing the positive list). This does not eliminate the need for additionality testing.

BASELINE SETTING

Baselines define the counterfactual scenario against which actual performance is measured—leading to credits for emissions below the baseline. Methodologies set out the rules for calculating baselines. The government has indicated the ERF will have two types of methodologies—activity (for specific emissions reduction activities) and facility (for a combination of activities undertaken within the same facility). The ERF will therefore need to establish robust baselines at the activity and facility level. Experience from other crediting schemes suggests:

- Baseline-setting will be one of the major administrative elements and sources of cost for the ERF.
- Clear rules on how to set baselines help achieve consistent treatment of similar projects, reduce uncertainty for project proponents and simplify scheme administration.
 - Governance is important: roles and responsibilities for determining the rules and approving baselines should be clear. Baselines should be set according to established rules, in a transparent and predictable way.
 - Crediting under facility methodologies should be consistent with relevant activity methodologies; it may be helpful to develop related methodologies in parallel.
- Activity methodologies are commonly used in other schemes.
 - Many could be adapted for use in Australia, helping to accelerate the participation of a wider range of activities in the ERF.
 - The ‘right’ baseline depends on the type of activity and its particular application; both intensity (that is, emissions reductions per unit of activity) and absolute (total emissions) baselines could play a role.
- Facility methodologies are less common but, once established, can provide greater flexibility in the types of activities undertaken, and reduce measurement and audit costs (compared with activity methodologies).
 - Facility methodologies would still need to demonstrate that emissions reductions are additional.
 - Intensity baselines can be difficult to define for facilities with multiple products. Absolute baselines may be easier to establish, but risk crediting emissions reductions that result from a normal fluctuation in production.
- Historical emissions data is not necessarily a good proxy for future business-as-usual emissions.
- Emissions data is necessary but not sufficient for developing baselines—a good understanding of the emissions reduction activities and their alternatives (including data on technologies and production processes) is also required. Production data is also required for intensity baselines.
- It is important to clearly define how baselines change over time.
 - There is a trade-off between ensuring baselines are robust and providing more certainty to project proponents. The appropriate balance will vary across different activities and sectors, so a flexible methodology-by-methodology approach is warranted.