Australia’s Clean Energy Future Package:
How does it compare with the EU’s approach?

On November 8, 2011, the Australian Government passed the so-called “Clean Energy Future Package”. This set of 19 Acts includes a carbon tax of 23 AUD/tCO\(\text{2}\), to come into force on 1 July 2012, which will transition, from 1 July 2015, to a system of emissions trading. While it is based on the European model, the Australian carbon market includes several important departures from the European Union Emissions Trading Scheme, particularly in terms of sectoral coverage, price controls, governance, support for low-carbon technologies, and the management of complementary policies. The design of the Australian carbon market is thus of interest not only to domestic stakeholders, but to the evolution of carbon markets and climate policy elsewhere.

Background: Climate policy context

Few issues have polarised Australian public opinion in recent times more than climate change. On the one hand, Australia’s difficult climate makes its citizens especially sensitive to climatic changes and extreme weather events. On the other hand, as the world’s largest exporter of coal – Australia is home to several of the world’s largest mining multinationals, the country profits significantly from the sale of fossil fuels and minerals to emerging markets. Indeed, Australia is sometimes referred to as being “the Saudi Arabia of coal” (albeit with some exaggeration). It was the highest per capita emitter in the OECD in 2005 (WRI, 2012).

The passage of the “Clean Energy Future Package” on November 8, 2011, with the support of an alliance of the minority Labor Government, the Greens and 3 independents is the culmination of long and divisive political debate. Similar legislation, including a carbon market, had been blocked by the Senate twice in 2009, and Australia only ratified Kyoto Protocol after a change of Government in 2007. Moreover, the current Package was voted in over the strong opposition of the conservative Coalition, which although internally divided, has publically pledged to roll back the carbon pricing mechanism if elected to government.

The first aim of the Package is to help Australia meet its national climate pledges under the Copenhagen Accord, i.e. to reduce emissions to 5% below of 2000 levels by 2020. As per Australia’s Copenhagen pledges, there is also an option to move to -15 or -25% in the event of a satisfactory global agreement. Compared to Europe’s targets of reducing emissions by 20% below 1990 levels by 2020 (or by 30% in the event of an international agreement) these may look like a distinct lack of ambition. However, a booming minerals sector, high population growth, a lack of immediate alternatives to coal-fired electricity, and difficult short-term politics are all factors in explaining its short-term emissions targets.

The second aim of the Package is to kick-start the low-carbon investment, innovation and behavioural change needed to transform the economy more over time. The Package therefore sets up a suite of mechanisms, new authorities and financing programs, with a view to creating a broad regulatory structure to drive more fundamental change.
News: the details of the “Clean Energy Future Package”

The Clean Energy Future Package is essentially based upon three legislative pillars: the Clean Energy Act, which establishes a carbon pricing mechanism; a Clean Energy Regulator Act, which sets up a body to administer the carbon pricing mechanism, renewable energy policies, and the Carbon Farming Initiative; and the creation of a Climate Change Authority, which will monitor and review the progress of the Package and provide periodic recommendations to Parliament. The carbon pricing mechanism is the key element of the package. Its main innovations with respect to the European Union Emissions Trading Scheme (EU ETS) - namely in terms of coverage, governance, price controls and approach to carbon leakage - form the central focus of this brief.

The carbon pricing mechanism: broader coverage than the EU ETS

More sectors covered directly by the pricing scheme...

The Australian pricing scheme will cover more sectors and a higher percentage of emissions than the EU ETS. As in the EU ETS, direct emissions from heavy industry (e.g. cement, metal processing, chemicals) and energy production (e.g. electricity and refining) will be covered. However, the Australian scheme will also cover fugitive emissions (e.g. from coal and gas mines) and implied emissions from the sale of transport fuels (for domestic aviation, maritime and rail, with road transport generally treated via other taxation). It will also go further than the EU ETS by covering emissions linked to the disposal of landfill waste from 2013.

Less than 500 large companies will be covered directly, representing ~60% of CO₂ emissions in the country. This compares to the EU ETS’s 5000 companies, which represent ~45% of EU emissions.

...and a dedicated scheme for extending the carbon price to agriculture and forestry: the Carbon Farming Initiative

In addition, the agriculture and forestry sectors have the option to enter the scheme to sell carbon credits – so-called ACCU (Australian Carbon Credit Units) – earned for projects concerning changes in land-use practices that reduce emissions or sequester carbon. Credits are granted by the Government for each tonne of carbon sequestered or eliminated under certified projects, based on methodologies which are validated under the Carbon Farming Initiative. These credits can then be sold to complying companies under the following conditions:

- From 2012 to 2015, ACCUs can be used to cover up to 5% of their emissions, as part of their obligations with the pricing scheme;
- From July 2015, this limit is raised along with the eligibility of certain international credits, to up to 50% of emissions (see International credits, p.6).

The Australian Government has dedicated 250 million AUD and elicited a call for tender to accredit eligible projects in order to provide early demand and stimulate the creation of a market for ACCUs under the CFI.

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1 Note that the CFI also allows the certification of projects reducing emissions in subsectors that are not counted towards the Australian Kyoto target. These projects would generate a different kind of credits, destined to the voluntary market, named the non-Kyoto ACCUs.
Climate Brief N°15 – Australia’s Clean Energy Future Package: How does it compare with the EU’s approach?

Figure 1 - Sectors covered by the Australian carbon price and their share of national emissions

Note: Actual coverage of the scheme in the “directly covered” sectors will be slightly lower than the totals given here as only companies emitting above a certain threshold will be covered by the scheme and some sub-sectors of these sectors will not be covered. The figures given here are nevertheless broadly indicative.

Data: UNFCCC (2009 emissions data).

Strong governance and low-carbon technology financing mechanisms

An independent Climate Change Authority (CCA) based on the UK model

This independent body, to be composed of nine experts in the science of climate change, economics, emissions measurement and finance, is mandated to inform the government by giving recommendations on:

- The evolution of the ETS emissions cap and national emissions reduction trajectory;
- Possible changes in the price floor or price ceiling;
- The eligibility criteria of international credits and allowances;
- Interactions between carbon market and related policies, such as the 20% Renewable Energy Target, energy efficiency policies, etc.

Its reviews and advice will not constrain the Australian Parliament to whom the final decision on all matters ultimately belongs. However, it is intended that the Climate Change Authority should influence the decision-making of successive Governments, by providing a public and highly credible expert opinion, which is independent of the Government of the day. It is perhaps also hoped that the independent authority will help to ensure a greater continuity of policy independently of the political cycle, as similar authorities have done in the UK.

Built-in supply-side adjustment mechanisms: interesting for the EU ETS?

Reacting to the EU’s experience with its own ETS, which has witnessed a sharp decline in the CO₂ price in response to the current economic recession, Australia has opted for a more flexible approach to setting medium-term emissions caps. The Australian ETS will work on a fixed 5-year rolling emissions cap\(^2\), which is set within the context of a longer term reduction target fixed by the Parliament, based on the advice of the Climate Change Authority.

\(^2\) At the end of each year, the year n+5’s emissions cap will be set.
In making its recommendation, the CCA must take into account a range of factors, including progress in reducing emissions domestically, the effect of related policies such as the Renewable Energy Target on the CO₂ price, international action, emissions credit supply, and “such other matters (if any) as the Climate Change Authority considers relevant.”

The success of the 5-year rolling cap approach in Australia will depend on at least two things: firstly, whether an Australian government that is hostile to climate change policy in general will listen to the CCA’s recommendations, or simply reject them; secondly, how long it takes the CCA, in cooperation with the government, to establish its credibility in managing medium-to-long-term allowance scarcity expectations with the market. Such an institution would have no track record and would not have absolute control over allowance supply, but would depend on its reputation and its influence with successive Governments to manage future allowance scarcity expectations.

The Clean Energy Regulator: centralising clean energy and climate policy

This independent entity will be in charge of allocation and auctioning, the emissions and allowances registry, monitoring, reporting and verification of emissions and the administration of the Carbon Farming Initiative. This body will also be responsible for defining targets for renewable energy under the Renewable Energy Target legislation, whose objective is to increase the country’s renewable energy share to 20% of total consumption by 2020. The decision to combine the governance and administration of renewable energy policy with the carbon pricing mechanism under the Clean Energy Regulator and the Climate Change Authority should help to alleviate problems of overlapping policies undermining the carbon price signal as occurred in the EU ETS under the “20-20-20 in 2020” policy.

The Clean Energy Regulator will also have the power to impose sanctions in the case of non-compliance and other illegal behaviour. Learning from the EU ETS, the Australian scheme has taken great pains to ensure that the legal status of allowances is clear from the outset – they are property rights – so that the risk of disruptions from fraudulent behaviour and inadequate market oversight is minimised.

Complementary policies, agencies and funding for low-carbon technology

The Australian Government’s Clean Energy Package also recognises the importance of tackling both market and non-market barriers to the effectiveness of the carbon price signal. It has therefore put in place a large number of programs to help develop and deploy clean energy technologies. Some of the main ones are:

- **The Clean Energy Finance Corporation**: an independent entity managing 10 billion AUD that will help finance and commercialise renewable energy technologies;
- **The Australian Renewable Energy Agency (ARENA)**: an independent agency for administering R&D programs in renewables including existing programs;
- **The CCS Flagships program**: a pre-existing program allocating 1.7 billion AUD to developing a large scale CCS facility in Australia’s south-west;
- **Clean Technology Program**: a program of support for R&D in low carbon technologies with 1.2 billion AUD planned for 2012-2015;
- **Carbon Farming Initiative and Carbon Farming Futures program**: a 250 million and a 429 million AUD programs respectively to help farmers engage in the carbon market and improve the carbon efficiency of their production.

The closest equivalents to these measures in the EU would be the proposed “Green Bank” in the UK and the sale in 2011/12 of part of the New Entrant Reserve allowances by the European Investment Bank to finance large-scale test projects in carbon capture and storage and renewable energies. In the EU, however, policies currently vary across Member States and are therefore not harmonised in the same fashion as Australia. Increased auctioning of
emissions allowances in the EU ETS from 2013 will give the chance to Member States to use part of these significant new revenues for financing low carbon technologies.

**Carbon price controls**

**Gradual phase-in of flexible prices**

To allow for a better preparation of the use of trading by companies, the Australian carbon pricing mechanism will be phased in over two stages:

1. **A "fixed price phase" between 1 July, 2012 and June 30, 2015:** The price of an allowance is set for the first year at 23 AUD/tCO₂ (≈18€/tCO₂) then increased by 2.5% annually in real terms. During this phase, emissions of installations subject to the scheme will not be capped. However, they will be required to purchase from the Government, at the fixed price, an emissions allowance for each ton of CO₂ emitted during the previous fiscal year (July to June in Australia). The carbon trading scheme will therefore work as a carbon tax during this 3-year first phase.

2. **A "flexible price" from fiscal year 2015-2016:** From July 2015, the scheme will then move into a full carbon “cap and trade” market scheme, similar to the EU ETS, with a fixed and declining annual cap on emissions of the complying companies. The price will therefore no longer be fixed but rather will be determined by trading in a market of tradable allowances, where it will depend on supply and demand. The caps for the flexible price phase have yet to be determined, but will likely be in line with the national goal of a 5% emissions reduction below 2000 levels by 2020.

**Price floor and price ceiling**

The Australian carbon market will seek to control price once the flexible price comes into operation through the use of a price floor and a price ceiling. This stands in contrast to the EU ETS, where no price controls exist.

**Figure 2 - Australian carbon tax and price control forecast (2012/13-2025)**

Note: Assumes inflation of 2% p.a.; takes current secondary CER futures price for 2015 delivery as a basis for the international unit price upon which the price ceiling is determined.

The price floor will be equal to 15 AUD (≈12€/tCO₂) for the first year of implementation, then increased by 4% per year above inflation. It will take the form of an auction reserve price, whereby bids below 15 AUD will not receive allowances. The aim of the price floor is to ensure a price signal for firms to engage in low carbon investments in the longer term, and also to ensure that Australian companies undertake a reasonable degree of domestic effort to reduce emissions.
For the first year, the price ceiling will be set at 20 AUD above an “international price per unit” for allowances, and then increased by 5% per year above inflation in following years. The price ceiling for fiscal year 2015-2016 will be determined by March 31, 2014. The price ceiling for the next two years will be determined before the start of each. When the price ceiling is reached, a fixed charge per unit will apply to all allowances issued by the regulator. It should be noted however that the price cap is unlikely to be utilised when the market begins because of the large supply of foreign credits that will be eligible to be used in the flexible price phase of the scheme. It would thus only be utilised in the extreme case of a lack of supply of cheaper international credits.

A challenge: applying the price floor to the use of international credits

However, Australia faces a major logistical challenge to the implementation of the price floor because it is in fact very difficult to square a price floor while allowing a high percentage of international credits into the scheme for compliance. In particular, the current price of Certified Emissions Reductions for use in the Australian scheme is around 4€/tCO$_2$e (~5 AUD), while the price floor in 2015 will be 15 AUD.

In a compromise between the Labor Government and the Greens, who jointly agreed on the legislation, the floor price will also be applied to the use of international credits. Specifically, an "international unit surrender charge" will be used, which will be a kind of “top-up” fee to be paid by companies surrendering international carbon credits for compliance if the cost of purchasing credits was cheaper than the price floor. In such cases, the international unit surrender charge will be equal to the difference between the unit price and the floor price. However, this has raised the challenging practical problem of how that difference could reliably be calculated by the government for each credit purchase.

At present the preferred route of the government and industry appears to be the following. The international unit surrender charge would be calculated from the observed international price – whatever that may be – though allowing the company to notify the government registry of its intention to surrender a credit before the official surrender date and thus to hedge negative price risk by locking in a unit surrender charge in advance. This would let willing companies speculate on the best moment to lock in their unit surrender charge, while allowing others to hedge.

International credits, banking and borrowing

As a relatively small share of global emissions and relatively higher marginal abatement costs compared to other countries, Australia is interested in linking its ETS with international markets and other ETS as much as possible. A link with the EU ETS, New Zealand ETS, or the future Californian, Chinese or Korean markets remains a medium-to-long-term goal and indeed Australia is more likely to link to Asian and Pacific countries markets before linking to the EU ETS. In the short term, though, Australia will seek to link indirectly by allowing a large share of international Kyoto credits into its market to be used as an alternative means of compliance. In the first 3 years of the flexible price phase, Australia will thus allow up to 50% of company compliance to be met by the use of eligible Certified Emissions Reductions (CERs), Emissions Reduction Units (ERUs) and Removal Units (RMUs)$^3$ coming from overseas, with 100% thereafter. This compares with only 13.5% over 2008-2012, and no new credits over 2013-2020, in the EU ETS.

During the whole flexible price phase of the scheme, allowances will be able bankable indefinitely without restrictions. On the other hand, borrowing from the following year's “vintage” of allowances will be allowed up to a maximum of 5% of the compliance needs.

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$^3$ As in the EU ETS, CERs and ERUs relating to nuclear projects, large hydro projects, time-limited forestry projects and certain industrial gases such as HFC23 will not be eligible. RMUs are not allowed in the EU ETS but will be allowed in Australia.
**Industrial competitiveness & sector adjustment**

**Free allocation and industry assistance**

Having learned from the experience of the EU ETS in Phase 1 and 2, Australia will auction, rather than freely allocate, a majority of emissions allowances from the start of the flexible price phase in mid-2015. The remainder of allowances will be allocated for free to so-called energy-intensive trade-exposed industries – similarly to the EU ETS in Phase 3. As in Phase 3 of the EU ETS, Australia's free allocations will use both emissions-intensity benchmarks and historical production data for determining allocations. However, Australia’s benchmarks will be based on the Australian industry average emissions-intensity rather than the best 10% of installations as in the EU ETS. This difference reflects Australia’s much lower number of installations, which makes calculating reliable and “fair” industry benchmarks difficult.

While the EU ETS separates covered activities into “at risk/not at risk of carbon leakage” based on three criteria measuring the cost impact and trade-intensity of carbon pricing, Australia will separate activities into three categories:

1. **Non-trade-exposed and energy-intensive**, e.g. electricity. These activities will in general receive no free allocation. However, some electricity generators will be supported via an Energy Security Fund (5.5 billion AUD), which gives them free allowances or subsidies in case of difficulties in repaying loans in exchange for commitments to invest in renewable energy. This is similar in the EU to the granting of free allowances to electricity generators in coal-intensive new Member States in Phase 3 to finance technology upgrades.

2. **“Moderately” trade-exposed and energy-intensive**. These activities will initially receive free allocation equal to 66% of their historical production multiplied by the sectoral-average emissions benchmark.

3. **“Strongly” trade-exposed and energy-intensive**. These activities will receive free allocation equal to 94.5% of their historical emissions multiplied by the sectoral-average emissions benchmark.

Free allocations will decline by 1.3% per year to ensure incentives remain for improving energy and emissions efficiency over time. Such an automatic measure is not currently envisaged for trade-exposed activities in the EU ETS, where benchmarks are already considered to be based on best available technology in many cases. In the EU ETS, the periodic reviews of the activity benchmarks in Phase 3 could in theory assess whether benchmarks should be changed based on technological improvements.

Similarly to the EU ETS’ rules under the New Entrant Reserve, significant capacity expansions will be eligible for additional free allocations, but plant closures will see related allowances surrendered, even for the year in which the plant closed – unlike the EU ETS.

**Specific adjustment plans for the “strategic” sectors**

Activities considered as “strategic sectors” of the Australian economy will receive additional funding through a 1.6 billion AUD program. This will apply to various sectors, but especially to the coal industry, steel mills and the LNG sector.

The Coal Sector Jobs Package will, for example, provide 1.3 billion AUD over the first 5 years of the scheme to so-called “gassy” coal mines to ease the transition to carbon pricing and mitigate the risk of significant employment effects on local communities. The assistance will be provided in proportion to the emissions from the mines above a given benchmark and must be used for abatement or other means of managing carbon liabilities.

In a similar manner, the Steel Transformation and Advanced Assistance Plans will provide over 400 million AUD to steel companies for them to engage in low-carbon R&D, improve their productivity, and environmental performance; and provide targeted skills training for employees.
Similar programs to help finance low-carbon investment will also exist in the food and foundries sector, as well as other manufacturing firms. For example, the Food and Foundries Investment Program will provide grants of up to $150 million over six years to the food processing industry and up to $50 million over six years to the metal forging and foundry industries. The Clean Technology Investment Program will provide 800 million AUD in grants to manufacturers to support investments in energy efficient capital equipment and low-pollution technologies, processes and products.

Conclusions: Some uncertainties remain

Perhaps the most important uncertainty surrounding Australia’s new climate policy package is whether the carbon pricing mechanism as currently designed will be able to withstand a change of government from Labor to the Coalition. Coalition Leader, Tony Abbott, is a renowned “climate skeptic” and has made the overthrow of the government's carbon tax and a super-profit tax on mining companies a central pillar of his campaign to unseat the Government at the next federal elections which are due in 2013. At the time this Brief was being written, his party was leading the Labor Government on a two party preferred basis of around 54–46% in the opinion polls.

The conventional wisdom among Australian carbon market circles is that the Coalition would find it hard to throw out the carbon pricing package. The argument is as follows: firstly, they would need to have exclusive control of the Senate to change the law, which is not guaranteed. Secondly, even with control of the Senate, the Coalition would need to either put a stop to roughly 8 billion AUD compensation payments to Australian households, or else find alternative financing for it, while cutting down the pricing mechanism. Thirdly, many of the Coalition’s own business constituents are likely to be unhappy with the additional uncertainty which scrapping the scheme would create, and could have already bought carbon credits for compliance, or have registered projects via the Carbon Farming Initiative. Finally, the Coalition is internally divided on the carbon pricing issue. It therefore seems likely that Australia has now crossed the point of no return for carbon pricing.

However, while a new government might not go back on pricing carbon entirely, it could do other things that would change the scheme significantly. For example, assuming it had control of the Australian Senate, it could rescind the price floor. Doing so would force the Australian carbon price to plummet, given the large supply of very cheap offsets that would flood the scheme. This would effectively leave the carbon pricing mechanism unable to generate incentives for large structural investments domestically, especially in the electricity sector, and for behavioural change by domestic actors. While lower carbon prices in theory should make way for stricter futures emissions caps in the ETS, they might not be politically sustainable. The surrounding uncertainty would thus generate additional difficulties for Australian low-carbon investors. Indeed, even if the price floor were to remain in place, similar questions could nevertheless arise from 2015 when Australia becomes the largest buyer of CERs worldwide, as the quantitative limit on credit use will have been reached in the EU ETS.

In the long term, Australia seems interested in linking the scheme to foreign carbon markets. The obvious choices for Australia would be New Zealand as a first step, followed possibly by Asian countries, such as China and South Korea, with whom Australia already has economic links and common interests. Talks on a potential link with the EU ETS have already taken place. However in the short term, Australia’s different scheme design in areas such as offset use and price controls would pose significant challenges to linking to the EU.
Annex 1 - Comparison of Australian carbon price and EU ETS

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<th>Sectoral Coverage</th>
<th>EU ETS(^4)</th>
<th>AUSTRALIAN SCHEME</th>
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<tr>
<td><strong>Sectors directly covered:</strong> Electricity &amp; heat, heavy industry, aviation</td>
<td><strong>Sectors directly covered:</strong> Electricity &amp; heat, heavy industry, fugitive emissions, non-legacy waste, aviation and other non-road transport</td>
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<tr>
<td>% of emissions directly covered: 45%</td>
<td>% of emissions directly covered: ~60%</td>
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<tr>
<td>Indirectly covered: domestic Joint Implementation (JI) projects in eligible sectors</td>
<td>Indirectly covered: eligible agriculture, forestry domestic projects certified by the CFI</td>
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<tr>
<td>Cap</td>
<td>-21% viz. 2005 levels by 2020</td>
<td>TBA; expected to be in the order of ~5% viz. 2000 levels by 2020</td>
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<td>Offsets</td>
<td>Allowed up to ~13.5% of allocation in Phase 2 for eligible projects (no RMUs, v. large hydro, nuclear or HFCs or N(_2)O projects). An estimated 0.9% of allocation in Phase 3, in addition to the unused quota for phase 2.</td>
<td>The flexible price phase of the scheme will allow eligible (non-HFC or N(_2)O) international offsets (CERs and ERUs) to be used for up to 50% of compliance from 2015/16, increasing to 100% from 2018/19. Domestic offsets will also be allowed for use from Kyoto-eligible Carbon Farming Initiative projects.</td>
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\(^4\) EU ETS parameters are based on Phase 3.
### Allocation & Competitiveness

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<th><strong>EU ETS</strong></th>
<th><strong>AUSTRALIAN SCHEME</strong></th>
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<td>Majority auctioning from 2013, with 100% auctioning for the power sector in Western Europe. In the New Member States, transitional free allocation for the modernisation of particularly carbon-intensive generators. Energy-intensive trade-exposed industries receive free allocations based on a best-performance benchmark x historical activity levels. No free allocation phase-out factor for sectors deemed at risk of carbon-leakage. All other sectors will be phased out by 20% in 2013 rising to 70% in 2020. A review of allocations will take place in 2014. Possibility of state-aid on an individual country basis for sectors particularly exposed to electricity cost increases.</td>
<td>Majority auctioning for the electricity sector from 2015/16, with an Energy Security Fund (5.5 billion AUD), which may give generators free allowances or subsidies in case of difficulties in repaying loans in exchange for commitments to invest in renewable energy. Division of energy-intensive trade-exposed industries into three categories. - Not trade-exposed: no free allocation. - “Moderately” trade-exposed: initial allocation of 66% of their historical production x the sector average emissions-intensity. -“Strongly” trade-exposed: initial allocation of 94.5% of their historical production x the sector average emissions-intensity. Allocation to be reduced by a 1.3% per year carbon productivity factor. Free allowances to compensate for sectors particularly exposed to electricity cost increases.</td>
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### Governance

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<td><em>Administration and Regulation</em> – DG Clima, EUTL, Member State Registries, Auction Monitor, ESMA, Member States Financial Market Authorities <em>Revision, Propositions for Reform</em> – DG Clima <em>Complementary policies/financing</em> – DG Clima, DG Energy, European Investment Bank, relevant Member State Ministries and Authorities</td>
<td><em>Administration and Regulation &amp; Surveillance</em> – Clean Energy Regulator <em>Revision, Propositions for Reform – Climate Change Authority</em> <em>Complementary policies/financing – Clean Energy Finance Corporation, Australian Renewable Energy Agency (ARENA)</em></td>
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### Structural adjustment & technology funding

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<td>Auctioning derogations for new Member States in Phase 3 Auction revenue recycling recommendations in ETS Directive.</td>
<td>A large number of specific sector-targeted programs, designed to assist in financing the uptake of cleaner technologies and practices.</td>
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