



Cabinet

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New Zealand Emissions Trading Scheme: Harmonisation with Australian Carbon Pollution Reduction Scheme

Portfolio: Climate Change Issues

Purpose This paper seeks agreement to establish a Trans-Tasman Officials Group (the Group) to work on options for harmonising the New Zealand Emissions Trading Scheme (NZ ETS) with the Australian Carbon Pollution Reduction Scheme (CPRS).

Previous Consideration None.

Summary

The Prime Ministers of New Zealand and Australia have agreed on the desirability of harmonising, to the greatest extent possible, the emissions reduction regimes in each country (the NZ ETS and the CPRS).

The NZ ETS is under review, pending the outcome of the review of the Climate Change Response Act 2002 (the Act), and the report of the Emissions Trading Scheme Review Committee (the Committee), expected in May 2009. The final shape of the CPRS, currently being developed, is unclear. Pages **3-4** note the potential issues for New Zealand regarding the development of the CPRS.

The Minister for Climate Change Issues (the Minister) is meeting the Australian Minister for Climate Change and Water, Senator the Hon Penny Wong, on 19 March 2009 to further the discussions on harmonisation. Appendix 1 on pages **8-9** provides an overview of the key areas of difference between the NZ ETS and the CPRS.

Agreement is sought to establish the Group, which will explore the risks and benefits of the options for harmonisation, and the practical steps required for harmonisation to occur. The draft Terms of Reference (ToR) for the Group is in Appendix 2 on pages **10-11**. Relevant Ministers will be authorised to approve the final ToR.

The paper notes that harmonising the NZ ETS and the CPRS may require:

[withheld]

Policy work on other areas of the NZ ETS will continue while the harmonisation

work takes place, including on forestry, consideration of whether to include the “50 by 50” target in legislation (a 50 per cent reduction of net greenhouse gases from 1990 levels by 2050), consumer assistance, and technical changes to the Act to improve the operation of the NZ ETS.

An indicative timetable setting out how the development and amendment of the NZ ETS could fit with the Committee’s process, and joint work with the Australian government to explore harmonisation, is in Appendix 3 on page 12.

Baseline Implications

[withheld]

Legislative Implications

Officials are investigating a number of possible amendments to the Act. It is intended that a Bill will be introduced following the Committee’s May 2009 report. Further amendments may be required to the Act, depending on the outcome of work on the potential for harmonisation.

Timing Issues

The indicative timetable for legislation required to put the CPRS in place extends to June 2009.

The level of harmonisation agreed on will affect when it can be achieved (i.e. a voluntary arrangement could take a few months, but a binding, treaty-level arrangement could take six months to two years).

Announcement

Following the meeting of the Minister with his Australian counterpart on 19 March 2009, there will be a need to communicate with stakeholders any agreed process for considering harmonisation, and any revised timetable for implementation of the NZ ETS.

Consultation

Paper prepared by MfE. Treasury, MED, MAF, MFAT, Transport, and Fisheries were consulted. DPMC was informed.

The Minister for the Environment indicates that there will be discussion with other parties represented in Parliament, but not with the government caucus.

The Minister for Climate Change Issues recommends that Cabinet:

- 1 note that the Prime Ministers of New Zealand and Australia have agreed on the desirability of harmonising, to the greatest extent possible, the emissions reduction regimes in both countries;
- 2 note that the Minister for Climate Change Issues is meeting the Australian Minister for Climate Change and Water, Senator the Hon Penny Wong, on 19 March 2009 to discuss harmonising the New Zealand Emissions Trading Scheme (NZ ETS) with the Australian Carbon Pollution Reduction Scheme (CPRS), which is still being developed;
- 3 agree that officials start a process, under a Trans-Tasman Officials Group, on the harmonisation of carbon pollution reduction schemes;

- 4 authorise the Minister for Climate Change Issues, in consultation with the Minister of Finance and the Associate Minister for Climate Change Issues, to work with the Australian Minister for Climate Change and Water to agree the Terms of Reference for the process, a draft of which is attached as Appendix 2 to the paper under CAB (09) 107;
- 5 **[withheld]**
- 6 note the need to continue policy work on other areas of the NZ ETS, including:
 - 6.1 forestry;
 - 6.2 consideration of whether to include the “50 by 50” target in legislation (a 50 per cent reduction of net greenhouse gases from 1990 levels by 2050);
 - 6.3 consumer assistance;
 - 6.4 technical changes to the Climate Change Response Act 2002 that would improve the operation of the NZ ETS (for introduction in the House of Representatives following the report of the Emissions Trading Scheme Review Committee, which is expected in May 2009).

for Secretary of the Cabinet

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Office of the Minister for Climate Change Issues

Chair Cabinet

New Zealand Emissions Trading Scheme – Harmonisation with the Australian Carbon Pollution Reduction Scheme

Proposals

1. I propose that Cabinet agrees to establish a Trans-Tasman Officials Group with the Australian government to work on options for harmonising the New Zealand Emissions Trading Scheme (NZ ETS) with the Australian Carbon Pollution Reduction Scheme (CPRS). A draft Terms of Reference for such work, discussed with Australian officials, is attached at Appendix 2.
2. Cabinet should also note the need to move forward in parallel with the development of aspects of the NZ ETS where that would enhance investor certainty, on the basis that this would not preclude harmonisation with the Australian CPRS in future.

Executive Summary

3. Harmonisation of the NZ ETS with the CPRS is likely to offer a number of potential benefits for the competitiveness of NZ businesses relative to trans-Tasman competitors, but there are also a number of potential risks. We should set up a Trans-Tasman Officials Group with the Australian government to explore the costs and benefits of the various options for further harmonisation, and the practical steps we would need to take to achieve this.
4. [withheld].

Background

5. At their meeting in Sydney on 1-2 March the Prime Ministers of New Zealand and Australia agreed on the 'desirability of harmonising to the greatest extent possible the emissions reduction regimes in both countries'. The key element of the emission reduction regime in each country is a broad based emissions trading system: the NZ ETS and the CPRS under development in Australia.
6. I am meeting with Hon Penny Wong Australian Minister for Climate Change on 19 March to further the discussions with the Australian Government.

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7. In June 2007 the governments of New Zealand and Australian established a Joint Officials Group on Emissions Trading Design (JOG), a high level officials group designed to share information on design of emissions trading schemes and therefore maximise prospects for future compatibility and linking. The JOG was chaired by the heads of Prime Ministers' Departments and reported to the two Prime Ministers. In August 2008, it was agreed that the work of the JOG should be suspended until 2009.

Comment

Benefits and risks of harmonisation

8. The NZ ETS is already strongly linked to emissions trading internationally, as it allows for the import and export of Kyoto compliant units. Harmonisation of the NZ ETS with the CPRS is likely to offer a number of potential benefits. Australia is a key trading partner, so harmonisation with the Australian CPRS is likely to provide greater protection for the competitiveness of NZ businesses relative to trans-Tasman competitors by ensuring that they are facing similar requirements and costs. Harmonisation could also reduce transaction costs for trans-Tasman firms and provide added insurance against any future period where the international trade in Kyoto compliant units is not possible. Harmonisation can broadly be defined as 'adopting similar policy settings which would facilitate mutual recognition of each other's domestic units now or at a later date'.

9. [withheld].

Options for harmonisation

10. Many levels of harmonisation between the NZ ETS and CPRS are possible, including:
 - Voluntary adoption of key design elements, but without mutual recognition of each others domestic units.
 - Mutual recognition of each other's domestic units via a voluntary arrangement or (more likely) a binding treaty-level agreement on key design elements (including reconciling Kyoto accounting), which would allow trading between the two schemes.
 - Full harmonisation, where the two schemes would effectively become one; which would likely require a binding treaty-level agreement.
11. It is possible for the two schemes to be more closely harmonised in some areas of design than others. This might enable New Zealand to manage some of the risks involved in greater harmonisation.
12. Appendix 1 provides an initial overview of the key areas of difference between the two schemes which are most likely to impact on the costs and competitiveness of New Zealand firms. It identifies those design features we would likely need to harmonise if we wanted to achieve mutual recognition of each other's domestic units (for example, rules relating to the import of Kyoto

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units); and other areas where it would likely be desirable to seek closer harmonisation (for example, allocation methodology).

13. It makes sense that we begin work now with the Australian government to explore the costs and benefits of the various options for further harmonisation, and the practical steps we would need to take to achieve this. We should therefore set up a Trans-Tasman Officials Group to take forward this work. This would represent a step change in our engagement with the Australians on Emissions Trading. The group should be jointly chaired by the Department of the Prime Minister and Cabinet and the Australian Department of Climate Change. The work should primarily be undertaken by officials from the Ministry for the Environment and the Australian Department of Climate Change, in conjunction with other departments where relevant.

Timing for any harmonisation

14. The level of harmonisation will significantly affect when it could be achieved. A voluntary arrangement could be enacted in a matter of a few months. A binding, treaty-level agreement could take 6 months to 2 years, and would likely require Parliamentary processes in Australia and New Zealand.
15. **[withheld]**.
16. **[withheld]**.

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17. A key short-term objective from our contacts with Australian Ministers and officials may be to ensure that the Australian CPRS does not contain elements that would preclude acceptance of New Zealand Units into the CPRS at relatively short notice, at a later date. This could include ensuring that the Australians will not apply to the NZ ETS the 5 year delay period they have proposed before linking with any scheme (they have already indicated that they could apply a shorter delay period in instances where linking will not significantly impact on the price of units).

Continued development of the NZ ETS

18. The NZ ETS is currently under review pending the government's legislative review of the Climate Change Response Act 2002, and the results of the Special Select Committee review, expected in May¹. We have previously made a commitment to amend the Act by September 2009. However, this timetable is now likely to be difficult to meet.

19. I have been investigating a number of potential amendments to the Act, such as setting a long term emissions target. In addition to this, a number of policy and implementation issues, important for the certainty of New Zealand firms (including Forestry sector firms who are already planning to sell allowances), are pressing, in particular:

- The finalised allocation plan for Forestry, which by law must be issued by 30th June 2009.
- Preparations for the planned inclusion of Stationary Energy and Industrial Processes, from 1 January 2010, including the development of emissions factors and a draft allocation plan. Meeting this timetable is now likely to be particularly challenging, given the work needed and the relatively short timescale.

20. **[withheld]**

21. There are a number of ways to defer the inclusion of Stationary Energy and Industrial Processes. One option would be to amend the Act to defer the introduction of the sector for 6 months (this would be the minimum delay period). Another option would be to consider an Order in Council (OIC) which could provide flexibility on dates for the introduction of sectors as well as other key aspects of the Act which would facilitate harmonisation with the Australian CPRS at a later date. The main downside from providing more flexibility is the extent of uncertainty it creates for participants in the scheme. In addition, it is likely to expose the government to ongoing pressure from stakeholders to delay entry of that sector into the ETS.

22. **[withheld]**

¹ N.B. The regulatory impact analysis of policies aimed at addressing climate change, which is due to feed into the Select Committee Review, will report on 15th April, to be followed by 2 weeks for further submissions. This means that the Committee cannot realistically report until May.

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23. In the case of Agriculture; as this sector is not in any case due for inclusion into the NZ ETS before 2013, no specific action or decision is needed at this time. In order to meet 2013 timeframes for the entry of agriculture, some policy decisions would be required by December 09. We will continue to consider policy options.
24. An indicative timetable, setting out how the development and amendment of the NZ ETS could fit with the special select committee process and joint work with the Australian government to explore harmonisation, is attached at Appendix 3.

Consultation

25. The following departments have been consulted on this paper: the Treasury, the Ministry of Economic Development, the Ministry of Agriculture and Forestry, the Ministry of Foreign Affairs and Trade, the Ministry for Transport, and the Ministry for Fisheries. The Department of the Prime Minister was also informed.

Financial implications

26. Any significant delay to the scheduled implementation of NZ ETS (in some or all sectors) or change in the nature of the scheme to match the Australian CPRS will likely have fiscal implications.

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27. Specifically, deferring the introduction of Stationary Energy and Industrial Processes into the NZ ETS for 6 months would have a net fiscal cost of \$100M for 6 months in 2010 (the government would forego receiving units for 6 months worth of emissions). This could be offset by bringing forward the introduction of transport to July 2010, which could have a \$175M fiscal benefit.

Human Rights

28. There are no inconsistencies between the proposals in this paper and the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993.

Legislative implications

29. We have already made a commitment to amend the Climate Change Response Act this year, and officials have already been investigating a number of potential amendments to the Act. Depending on the outcome of our work on the potential for harmonisation with the CPRS, further legislative amendments to the Act may be needed.

Publicity

30. The Government's interest in considering the options for harmonisation with the Australian CPRS was mentioned at the Special Select Committee hearing on 5th March. Following my discussions with Penny Wong we will need to communicate to stakeholders any agreed process for considering harmonisation and any revised timetable for implementation of the NZ ETS.

Recommendations

I recommend that Cabinet:

1. **note** that the Prime Minister's of New Zealand and Australia have agreed on the desirability of harmonising to the greatest extent possible the emissions reduction regimes in both countries.
2. **note** that the Minister for Climate Change Issues is meeting Australian Minister for Climate Change and Water, Senator the Hon Penny Wong, on 19 March 2009 to discuss harmonising the New Zealand Emissions Trading Scheme (NZ ETS) with the Australian Carbon Pollution Reduction Scheme (CPRS);
3. **agree** that officials should start a process under a Trans-Tasman Officials Group on harmonisation of Carbon Pollution Reduction Schemes;
4. **agree** to delegate authority to the Minister for Climate Change Issues, in consultation with the Minister of Finance and the Associate Minister for Climate Change Issues, to work with the Australian Minister for Climate Change and Water, Senator the Hon Penny Wong, to agree the Terms of Reference for this process, a draft of which is attached at Appendix 2.

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5. **[withheld]**:

6. **note** the need to continue policy work on other areas of the NZ ETS, including: Forestry; consideration of the inclusion of the '50 by 50' target into legislation; consumer assistance; and technical changes to the Act that would improve the operation of the NZ ETS, for introduction to the House following the report of the Special Select Committee, expected in May.

Hon Dr Nick Smith
Minister for Climate Change Issues
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Appendix 1: Overview of the Key Areas of Difference Between the NZ ETS and the proposed CPRS

[withheld]

Appendix 2

Draft Terms of Reference

Trans-Tasman Officials Group on Harmonisation of Carbon Pollution Reduction Schemes

Context

Taking into account:

- The statement of their two Prime Ministers on the 'desirability of harmonising to the greatest extent possible the emissions reduction regimes in both countries';
- The vital role of the Single Economic Market initiative in strengthening the two economies;
- The potential benefits for firms on both sides of the Tasman, including the reduction of transaction costs;
- The respective sovereignty of the New Zealand and Australian governments, and the differences between their two economies;
- The existing framework of international trading offered through the Kyoto Protocol flexibility mechanisms;
- The potential post-2012 framework of international trading and existing and developing international carbon markets;
- Existing work already undertaken to review scheme compatibility;

The New Zealand and Australian governments will work together to consider the costs and benefits of options for further harmonisation between the Australian Carbon Pollution Reduction Scheme and New Zealand Emissions Trading Scheme.

Issues for Consideration

Specifically, officials will consider:

1. Options for the level of harmonisation - including:

- Voluntary adoption of key design elements, but without mutual recognition of each other's domestic units.
- Mutual recognition of each other's domestic units, which would allow trading between the two schemes.
- Full harmonisation, where the two schemes would effectively become one.

It is possible for the two schemes to be more closely harmonised in some areas of design than others.

2. Priority Areas for harmonisation – specifically, areas where further harmonisation is likely to be particularly important for trans-Tasman competitiveness, which might include:

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- Rules for the import / export of units.
- Price caps.
- Allocation methodologies, particularly for emissions intensive, trade exposed sectors.
- Administrative arrangements, including monitoring, reporting and verification
- Sectoral coverage and point of obligation.

3. Practical issues – including the possible timing for any harmonisation to come into force and practical steps needed in each country to enact it.

Membership

The working group is to be convened under auspices of a Trans-Tasman Officials Group and jointly chaired by the Australian Department of Climate Change and New Zealand Department of the Prime Minister and Cabinet. The work is primarily expected to be undertaken by officials from the Department of Climate Change and the New Zealand Ministry for the Environment in conjunction with other departments where relevant.

Timelines

[withheld].

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Appendix 3: NZ ETS Legislative Review and Harmonisation with Australian CPRS - Indicative Timetable

[withheld]