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- ▶ Minister Responsible for International Climate Change Negotiations

For information by 20 February

MFAT Commentary on Proposed NZ ETS Decisions

Submission	Issues
Purpose	To provide an international perspective on proposed decisions concerning the New Zealand Emissions Trading Scheme.

Recommended referrals

- ▶ Minister for Climate Change Issues For information by 24 February
- ▶ Minister for Primary Industries For information by 24 February
- ▶ Minister of Finance For information by 24 February

Contact details

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Minister's Office comments

Signed / Referred
Date: ____ / ____ / ____

Key points

- Proposed amendments to the New Zealand Emissions Trading Scheme (NZ ETS) are designed to more closely gear the ETS to deliver reductions to meet a New Zealand mitigation commitment.
 - Without making these changes, the ETS would deliver mitigation well in excess of New Zealand's conditional 2020 target range, mostly through international purchasing.
 - The introduction of auctioning and establishment of a cap would be effective and desirable whether New Zealand took commitments under the Kyoto Protocol or the Framework Convention, and in the case of a Kyoto Protocol second commitment period, whether AAUs were issued or not.
 - Once the proposed amendments are introduced, a target (whether domestic or international) will be needed to underpin auctioning/cap.
 - The level of the cap will have implications for the level of New Zealand's international commitment, and vice versa.
 - Establishing a cap will facilitate linking with the Australian Carbon Pricing Mechanism (and other international trading schemes).
 - Decisions this year on which forestry rules will be applied in the NZ ETS do not predetermine where New Zealand's post-2012 commitments might be taken.
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Recommendations

It is recommended that you:

- 1 Note that the Economic Growth and Infrastructure (EGI) Committee is Yes / No scheduled to consider a suite of decisions on the Emissions Trading Scheme on Wednesday 29 February
- 2 Note that these decisions on the ETS are linked to broader climate Yes / No change policy issues, including the decision on whether take to emissions reduction target under the second commitment period of the Kyoto Protocol or the Framework Convention, and the level of the effort represented by the target.

Jo Tyndall

for Secretary of Foreign Affairs and Trade

Report

On 5 March Cabinet is to consider a set of decisions regarding amendments to the Emissions Trading Scheme. This submission provides an international perspective on some of the proposed amendments and discusses the relationship between international obligations, whether under the Kyoto Protocol or in the 2013-20 transition, and the ETS.

- 2 The key drivers for the proposed amendments are:
 - a. to ensure that the ETS more effectively supports the government's economic growth priorities: providing more flexibility and mitigating short-term costs for business whilst ensuring clear long-term price signals that encourage and smooth transition to a low-carbon economy; and
 - b. to ensure that the ETS is flexible enough to cater for a range of international outcomes in the period 2013-2020; and in particular can more precisely deliver the share of international reduction efforts that New Zealand assumes in this period.
- 3 Comments in this note relate primarily to proposals on:
 - the introduction of a mechanism to allow auctioning of New Zealand Units (NZUs), a cap on the number of NZUs issued (allocated and auctioned) and a restriction on the number of international units surrendered.
 - the introduction of offsetting for pre-1990 forests, to mirror the Flexible Land Use rule successfully negotiated at Durban.

The need for a cap

4 In the first commitment period New Zealand Units (NZUs) were backed by the AAUs issued in respect of New Zealand's QELRO. This effectively established a cap on national emissions, as emissions beyond the total emitted minus sequestration would need to be purchased abroad.

5 It is possible that AAUs will not be issued under the Kyoto Protocol's second commitment period, but the establishment of a cap on the number of NZUs allocated under the ETS would allow New Zealand's emissions to be limited to the level of the carbon budget established by the QELRO – in the event NZ decides to participate in the CP2.

6 Should New Zealand choose to establish its international obligations as a political commitment under the Convention track transitional arrangements, it would need to establish a national cap (which can be a responsibility target) through domestic regulation or legislation in order to give effect to the obligation. Many countries which have pledged emissions reductions under the Cancun Agreements, whether planning to commit under Kyoto or the Convention, have already embedded them in domestic law

Withheld under Section 56(a)

7 Under current settings, the ETS would well overshoot the level of reductions required to meet New Zealand's 2020 conditional emissions reduction pledge, mainly through purchase of international offsets. The establishment of a lower cap would avoid unnecessary transfer of wealth offshore and better tune the ETS to deliver New Zealand's eventual commitment. The level of the cap will have implications for the level of New Zealand's international commitment, and vice versa.

8 [Withheld under section 59(2)(g)(i)]

9 Establishing a cap in the ETS would also facilitate linking with the Australian Carbon Pricing Mechanism and, potentially, other international carbon trading mechanisms.

10 Although not reflected in the paper, one of the options officials have discussed is to move to a domestic-only scheme, effectively a carbon tax similar to the early stages of the Australian scheme. This has not been proposed in the Cabinet paper but the issue could re-emerge in discussion. Our concern would be that the level of mitigation delivered by such a scheme would be likely to well undershoot any credible 2020 target that New Zealand might take. It is also worth noting that while the Australian scheme commences as a carbon tax, in 2015 it is intended to mature into a trading scheme open to international purchasing.

Relationship with where target is taken

11 The proposed amendments to the ETS are not determinants of where New Zealand takes its post-2012 commitments. They are, in principle, applicable whether New Zealand's post-2012 obligations are taken under Kyoto or the Convention. However, from a technical perspective, decisions about the rule-set under which New Zealand would account internationally would give greater clarity around forestry options. []

[Out of scope]

12 While the operation of accounting rules under the Convention track transitional arrangements is not yet clear, [Withheld under section 59(2)(g)(i)] [] Even under the Kyoto Protocol, New Zealand may apply domestically whatever forestry rules it chooses. However, to the extent that domestic rules are inconsistent with the Kyoto rule set, the difference between the international accounting and what the domestic rule delivers would need to be met by the Crown rather than being devolved to foresters. Given the government's desire to apply forestry offsetting domestically, agreement to the Flexible Land Use rule in Durban has taken a complicating factor out of the amendments.

Other Issues: Trade and Investment

13 *Introduction of a levy for some Synthetic Greenhouse Gas activities:* MFAT has advised on ensuring consistency with WTO national treatment obligations by recommending that any levies imposed on imported products containing synthetic greenhouse gases are equally applied to domestically-produced like products.

14 *Amendments to the second tranche of allocation* [

Withheld under Section 59(2)(b)

15 *General recommendation to bolster the environmental justifications for the changes:* MFAT has also made a general recommendation that the paper be rephrased so that the environmental justification (i.e. to avoid over-allocation) for changes that may affect the value of foreign investors' investments in New Zealand is emphasised, and the paper does not rely solely on fiscal arguments.

16 Officials would be happy to provide further information on any issue raised in this paper if desired.

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