Linking National GHG Cap & Trade Schemes

A discussion of scenarios for linking the Australian CPRS and the New Zealand ETS
Background...

- Booz & Company is a leading global management consulting firm, helping the world’s top businesses, governments and other institutions.

- Global firm with 3,300+ professionals in 57 offices in more than 30 countries worldwide.

- Our firm is the oldest management consulting firm still in existence, the first to use the term ‘management consultant’, and the only firm to be a top-tier provider of consulting services in both the public and private sectors around the world.

- In 2008, we separated our operations from our U.S. Government consulting business, which retains the name Booz Allen Hamilton. We continue our work with businesses, governments and organizations around the world, now under the name Booz & Company.
Examples of our work in Low Carbon & Sustainability...

- Establishing the new Directorate of Energy & Climate Change within the UAE government
- Supporting the UNDP to elaborate capacity building plans across 11 developing countries to enable creation of Low Emissions Development Strategies, NAMAs & NAPAs and promote private sector participation in scaled-up mitigation actions
- Adapting established frameworks for threat assessments, vulnerability analysis and capability development from the security & intelligence communities to enable rapid improvements in resilience and recovery capabilities within developing economies
- Strengthening the regulatory frameworks and approaches for compliance and enforcement within Australia’s mandatory reporting system for energy use and carbon emissions
- Investigating potential for linking of RE credit markets, carbon compliance markets, bilateral and cross-recognition arrangements, and other new market mechanisms
Several factors make the case for linking Australia’s CPRS to the New Zealand ETS particularly compelling

### Case for linking CPRS and NZ ETS

| 1 Cost Savings | - A Trans-Tasman Scheme would **reduce compliance costs** for business given mutual recognition of domestic units and harmonised reporting obligations  
|               | - Linking would create opportunities for **sharing governance arrangements and technical resources** (e.g., auditors and accreditation resources) |
| 2 Increased liquidity | - Linking would **overcome liquidity constraints** that could hamper a standalone scheme  
|               | - Particular advantages would accrue to **New Zealand**, given its relatively **small scheme** and the government’s **intention not to auction units** but to buy units in international markets |
| 3 First steps towards international linkage | - Countries are **geographically close** with Australia being NZ’s nearest developed country  
|               | - Linking to NZ ETS would provide a **“test case”** and create momentum for Australia to pursue broader linking arrangements with other countries - **regional hub** could be formed by integrating Indonesia and PNG and potential links could be established with other Asian markets |
| 4 Consistency with growing economic ties | - A harmonised scheme would align strongly with Australia and New Zealand’s **existing economic and policy relationships**, with trade relations underpinned by ANZCERTA  
|               | - There are **significant economic benefits** to be yielded for both nations through linking |
| 5 Alignment of Scheme Coverage | - Both countries aspire to an **“all sectors, all gases”** approach in their respective Schemes  
|               | - NZ was the first country to cover **forestry** within an ETS and Australia has chosen to align itself to this position. Both nations are considering how to cover **agriculture** - another controversial sector |

### Source:
The CPRS contemplates four dimensions of international linking, from which flow three underlying decisions for the Government

### Dimensions of linking

<table>
<thead>
<tr>
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<th>Description</th>
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<tbody>
<tr>
<td>Direct</td>
<td>Units from Scheme A can be used for compliance purposes in Scheme B</td>
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<tr>
<td></td>
<td>E.g., CPRS accepts units from NZETS as valid compliance units</td>
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<tr>
<td>Indirect</td>
<td>Scheme A and B have no direct links but both accept units from Scheme C,</td>
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<tr>
<td></td>
<td>creating an indirect pricing link</td>
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<tr>
<td></td>
<td>E.g., CPRS and NZETS both recognise units created under the Kyoto Protocol</td>
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<tr>
<td>Unilateral</td>
<td>Units from Scheme A can be used in Scheme B, but not vice versa</td>
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<tr>
<td>Bilateral</td>
<td>Governments responsible for schemes A and B agree to accept units from</td>
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<tr>
<td></td>
<td>each other’s schemes</td>
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<tr>
<td></td>
<td>Entails mutual recognition of units or full harmonisation of scheme design</td>
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### Underlying decisions for Australian Government

1. The **number of international units** that would be accepted for compliance in Australia
2. The **types of international units** that might be accepted for compliance in Australia
3. Whether Australian Kyoto Units could be transferred / exported into international markets, and if so, how many

Source: CPRS White Paper - p. 11-4
While many Scheme design features must align to enable linking, we have shortlisted these to focus on key challenges and issues:

**“Laundry list” of design considerations**

- **Environmental / Target Integrity**
  - Core obligation (cap-and-trade vs intensity based model)
  - Scheme caps / national target commitments
  - Unit of trade (nature of domestic units)
  - Banking and borrowing
  - Price cap / safety valve
  - Offset provisions
  - Import restrictions (treatment of international Kyoto & Non-Kyoto units)
  - Export restrictions (sale and transfer)

- **Economic / Competitive**
  - Coverage (sectors and gases)
  - Commencement phase-in periods
  - Permit allocation

- **Technical**
  - Monitoring, reporting & verification (MRV)
  - Registry standards
  - Point of regulation
  - Penalties / enforcement provisions

**Filtered list**

- a. Nature of domestic compliance units
- b. Treatment of Int’l Kyoto Units
- c. Treatment of Int’l Non-Kyoto Units
- d. Export restrictions
- e. Price caps
- f. Commencement phase-in periods
- g. Monitoring, reporting, verification
- h. Penalties / enforcement provisions

Source: Categorisations proposed by IETA - “Linking the EU ETS with emerging emissions trading schemes”
In summary, some of these issues may create hurdles for deeper Australia-New Zealand Scheme linkage

### Impact summary of key design features enabling linking

<table>
<thead>
<tr>
<th>Design Feature</th>
<th>Degree of linking</th>
<th>Timing of linking</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Impact</td>
<td>Implication / Comment</td>
</tr>
<tr>
<td>a Nature of domestic compliance units</td>
<td><img src="circle" alt="Impact" /></td>
<td>A “common currency” already exists as both countries have stapled their domestic units to AAUs. The next step is for cross-recognition of AEUs and NZUs to occur</td>
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<tr>
<td>b Treatment of Int’l Kyoto Units</td>
<td><img src="circle" alt="Impact" /></td>
<td>Differential treatment of foreign AAUs is a major barrier to bilateral linking. Either Australia must relax CPRS by accepting AAUs or NZ must renege on accepting AAUs</td>
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<tr>
<td>c Treatment of Int’l Non-Kyoto Units</td>
<td><img src="circle" alt="Impact" /></td>
<td>At this stage no barrier to linking as Non-Kyoto units are not recognised by either Scheme. Potential future barrier if one country begins recognition and the other does not</td>
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<tr>
<td>d Export restrictions</td>
<td><img src="circle" alt="Impact" /></td>
<td>Export restrictions in Australia is a fundamental barrier to linking as AU emitters could not sell AEUs into NZ market. Restrictions must be removed to facilitate linking</td>
</tr>
<tr>
<td>e Price caps</td>
<td><img src="circle" alt="Impact" /></td>
<td>Price cap must be removed, a common price cap would have to be adopted, or the AU price cap would have to be raised so high so as to effectively not be accessed</td>
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<tr>
<td>f Commencement phase-in periods</td>
<td><img src="circle" alt="Impact" /></td>
<td>Not an in-principle barrier to bilateral linking given all-gases, all-sectors approach. Timing of phase-in periods is slightly contentious but not a long term hurdle to linking</td>
</tr>
<tr>
<td>g Monitoring, reporting, verification</td>
<td><img src="circle" alt="Impact" /></td>
<td>AU MRV standards appear more rigorous and it is unlikely AU Govt will relax its requirements. NZ Govt may have to tighten procedures e.g., assurance requirements</td>
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<tr>
<td>h Penalties / enforcement provisions</td>
<td><img src="circle" alt="Impact" /></td>
<td>Not a significant barrier to linking at this stage - Unclear which Scheme’s penalties are more severe but penalties should be aligned to enhance political acceptability</td>
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Linking scenarios can be considered across two dimensions - the degree of integration and the time taken to develop the links.

### Framework for evaluating linking scenarios

**Degree of Integration**
- More and more design features must align to facilitate an increasing level of integration.
- Greater alignment will also lead to greater political acceptability of a bilateral and/or harmonised scheme.

**Time Taken**
- Design features are expected to be progressively introduced over time.
- Time is required to conduct negotiations, agree to design features and form any necessary international/bilateral agreements.

- **Specific events/initiatives** that need to occur under each scenario can be identified and charted.
- Two extreme scenarios are used with additional scenarios created to illustrate the choices/implications:
  1. Only unilateral/int’l linking is pursued.
  2. Full Scheme harmonisation between CPRS and NZ ETS as soon as possible.
There are four key drivers that will make linking politically acceptable to both the Australian and New Zealand Governments

**Drivers conducive to linking**

1. **Outcome of international negotiations**
   - The outcomes of the UN Climate Change Conferences held in Copenhagen in 2009, Cancun in 2010 and Durban in 2011 will change the policy stance and legislative requirements of both Schemes

2. **Consistency with Scheme objectives of both countries**
   - Domestic politics in both countries have focused on climate policy and the implications of policy choices on individual and industry-level actors, which creates a dynamic set of objectives and policy constraints
   - Australia is renewing its policies after the recent Federal election

3. **Technical consistency across Schemes**
   - Key design features must be either mutually acceptable to both countries, aligned to a sufficient extent, or unified / harmonised under a single scheme in order to facilitate direct linking

4. **Timing of reviews to gain certainty**
   - The findings of independent reviews and advisory committees are a precondition to linking. The Australian Government has stated it will provide maximum feasible level of certainty about future linking arrangements, while the NZ ETS first review is in 2011…

Source: CPRS White Paper; Booz & Company analysis
While NZ has moved forward with its phased introduction of an economy wide cap & trade system, Australia is beginning again

- The NZ ETS is very real, and trading is thin but active
  - The small scale and phased introduction will continue to result in thin market activity
  - The full review of the NZ ETS in 2011 will further shape the implementation pathway and the pace at which NZ companies are exposed to full carbon pricing (or not…)

- The recently formed minority government in Australia will be actively considering a broad range of climate policy and carbon pricing options in the coming weeks and months
  - A multi-party Climate Change Committee is being formed to consider carbon pricing
  - The alliance between the Labor Party and the Greens will create pressure to act decisively on national climate policy, particularly after June 2011 when the alliance will have Senate majority

- While linking and integration between Australian & New Zealand carbon markets is still very likely, there are a number of interesting scenarios which should be considered
  - Tax vs trading vs tax-for-some-trading-for-others vs moving-from-tax-to-trade-over-time are all back on the table in Australia with a wide variety of opinions over timing of the scheme’s implementation and exposure for exporters
  - Adoption of stringent targets for renewable energy, energy efficiency and land-based activities will impact on the forms of linking environmental markets across the two countries