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Linking National GHG Cap & Trade Schemes

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



Background...

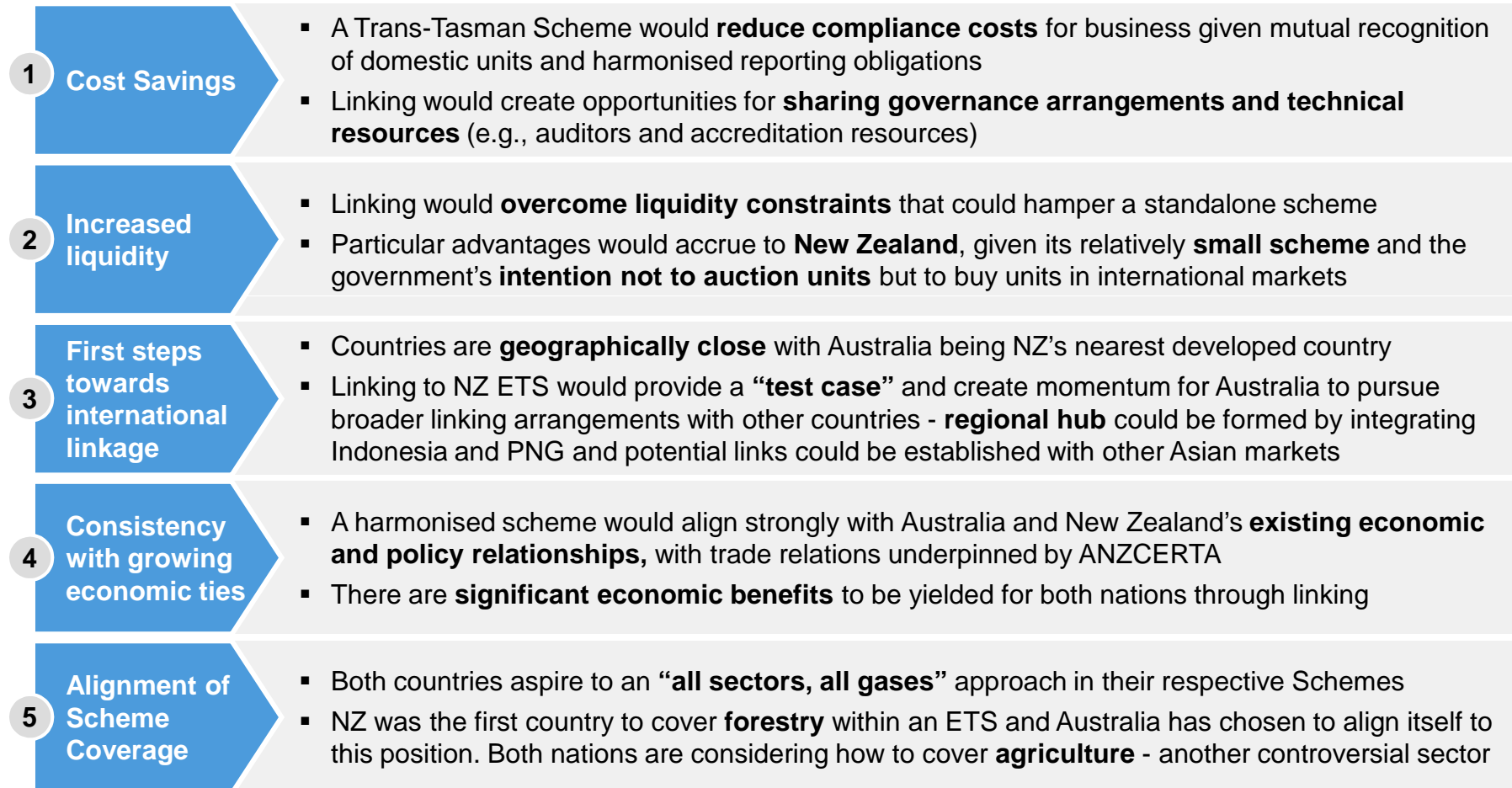
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- Our firm is the oldest management consulting firm still in existence, the first to use the term 'management consultant', and the only firm to be a top-tier provider of consulting services in both the public and private sectors around the world.
-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

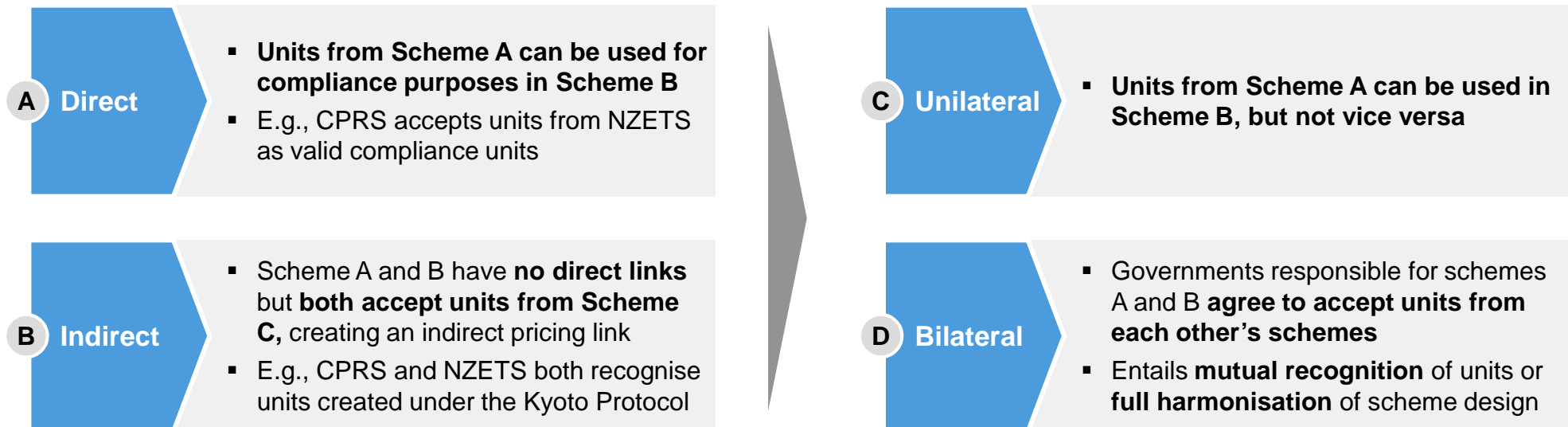
Case for linking CPRS and NZ ETS



Source: Jotzo and Betz - "Linking the Australian Emissions Trading Scheme" (Working Paper), 23 February 2008, p. 18-19; Booz & Company analysis

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

Dimensions of linking

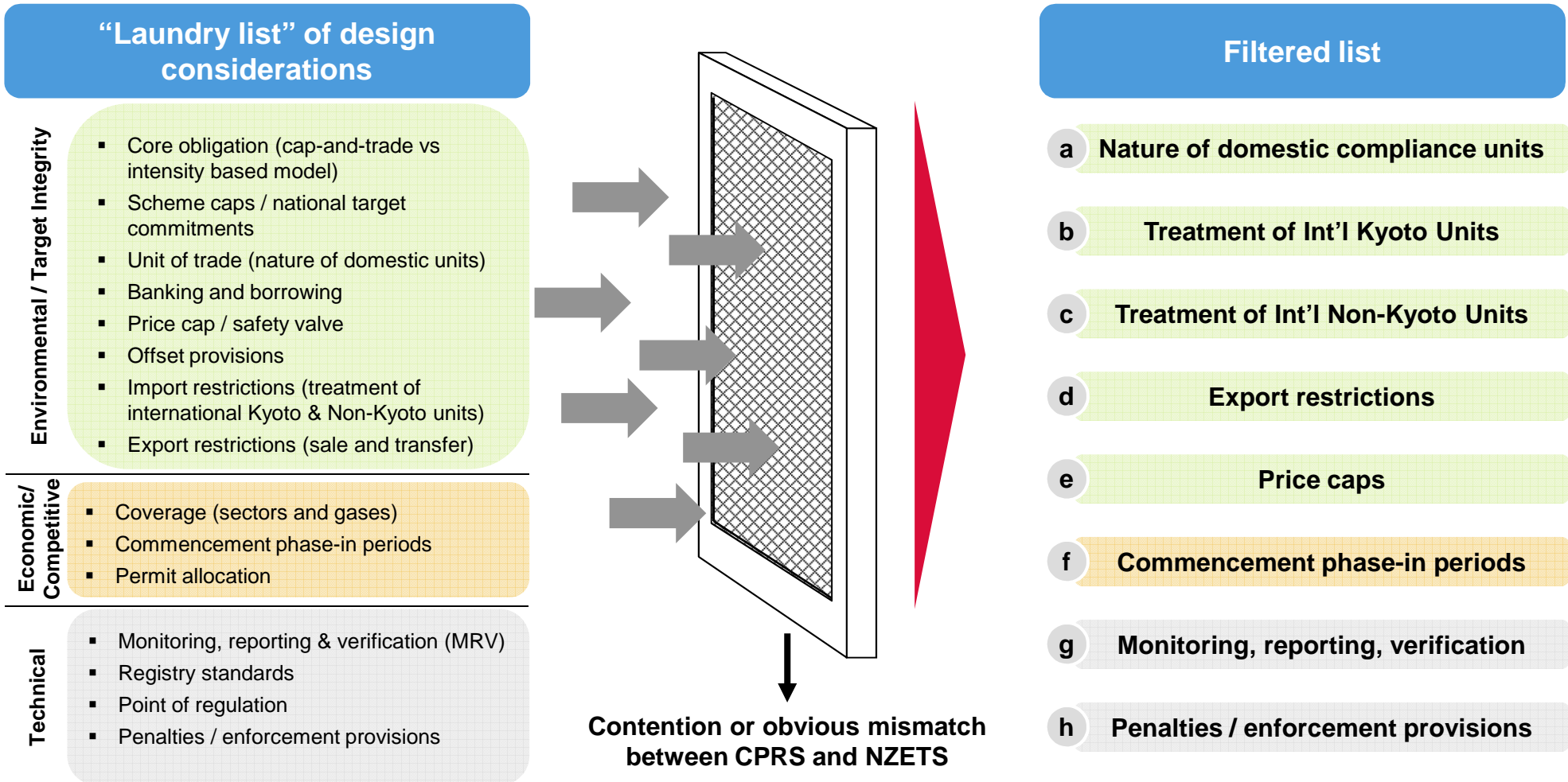


Underlying decisions for Australian Government

- 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



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

ILLUSTRATIVE

Impact summary of key design features enabling linking

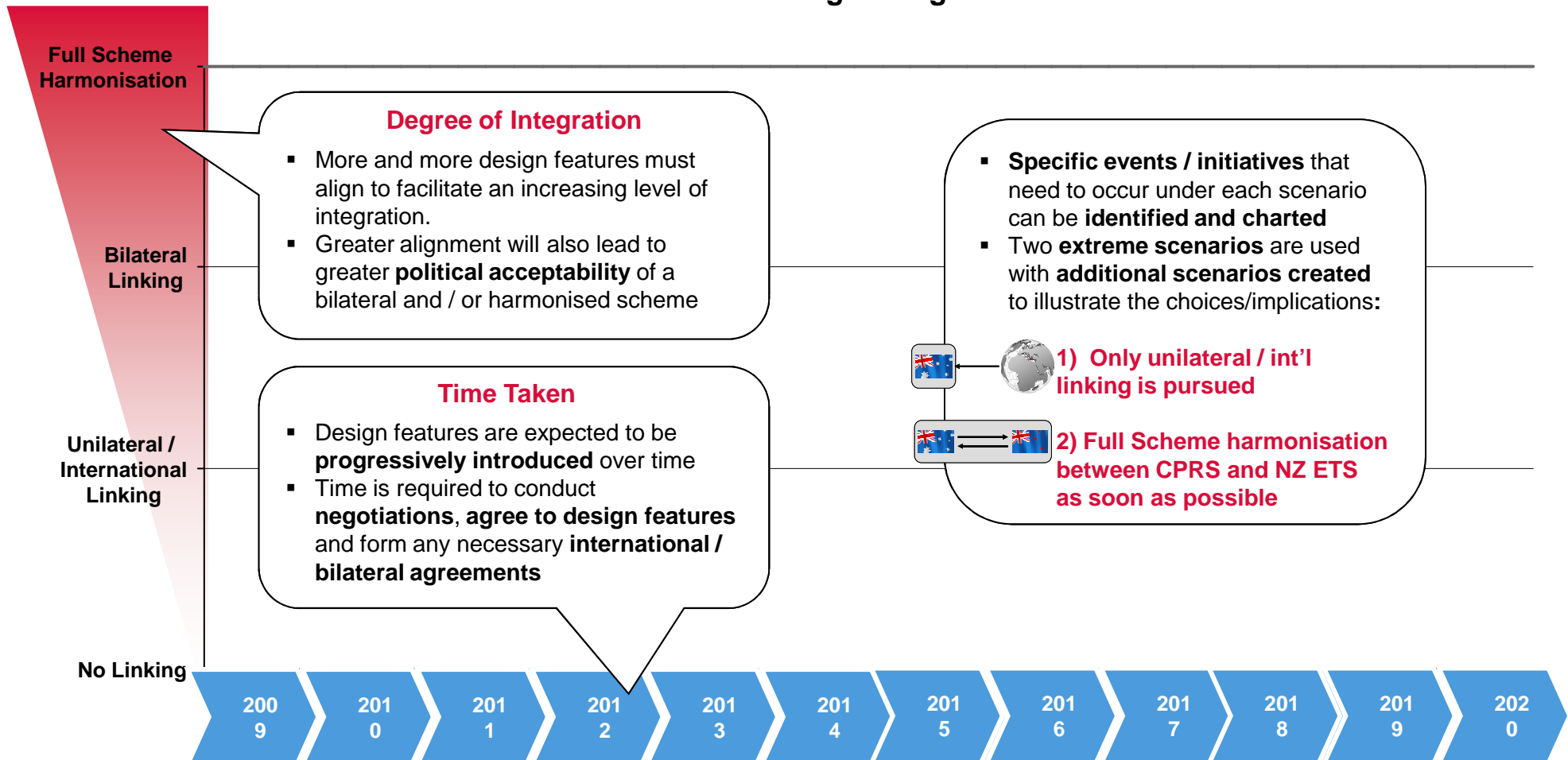
○ Marginal barrier to linking
Least time to implement

● Significant barrier to linking
Most time to implement

Design Feature	Degree of linking		Timing of linking	
	Impact	Implication / Comment	Impact	Implication / Comment
a Nature of domestic compliance units	○	<ul style="list-style-type: none"> A “common currency” already exists as both countries have stapled their domestic units to AAUs. The next step is for cross-recognition of AEU and NZU to occur 	○	<ul style="list-style-type: none"> Cross-recognition of domestic units would be quick to achieve - merely requires simple legislative amendments to each country’s ETS legislation
b Treatment of Int’l Kyoto Units	●	<ul style="list-style-type: none"> 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 	○	<ul style="list-style-type: none"> Unclear whether AU/NZ will change position on AAUs. AU would have to be assured of Scheme integrity and no significant price impact - this evaluation may take time
c Treatment of Int’l Non-Kyoto Units	○	<ul style="list-style-type: none"> 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 	○	<ul style="list-style-type: none"> AU to review its position for post 2012-13 period, but 5 years notice required if Non-Kyoto Units recognised. If status quo is maintained timing is not relevant
d Export restrictions	●	<ul style="list-style-type: none"> Export restrictions in Australia is a fundamental barrier to linking as AU emitters could not sell AEU into NZ market. Restrictions must be removed to facilitate linking 	●	<ul style="list-style-type: none"> Five years notice except for bilateral link. However, export restrictions not likely to be lifted any time soon given review requirements and study of price impact
e Price caps	●	<ul style="list-style-type: none"> 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 	○	<ul style="list-style-type: none"> Extensive negotiations may be required given political sensitivity - Price cap may compromise environmental integrity of NZ ETS while costly to AU if cap is accessed
f Commencement phase-in periods	○	<ul style="list-style-type: none"> 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 	○	<ul style="list-style-type: none"> Sectoral coverage not aligned until Agriculture phased-in in Australia in 2015. However, slight differential treatment of forestry and waste sectors may delay linking efforts
g Monitoring, reporting, verification	○	<ul style="list-style-type: none"> 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 	○	<ul style="list-style-type: none"> Mid-term negotiations may be required to align MRV stringency. N.B. after agreement reached, establishing joint registry and regulator may be time consuming
h Penalties / enforcement provisions	○	<ul style="list-style-type: none"> 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 	○	<ul style="list-style-type: none"> Alignment is relatively quick to implement - simple legislative change. Time is needed to reach agreement although this is not expected to be overly onerous

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



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...



Political Acceptability

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