

Environmental Defense Fund - Submission to New Zealand's Emissions Trading Scheme Review 2011

Background

[Environmental Defense Fund](#) (EDF) appreciates the opportunity to make a submission to the Emissions Trading Scheme Review 2011 ('the Review'). EDF strongly supports New Zealand's objective of designing an effective, broad, and internationally linked Emissions Trading Scheme (ETS) that can help New Zealand meet its international commitments in the most cost-effective manner possible.

About EDF

1. EDF's mission is to preserve the natural systems on which all life depends. Guided by science, we design and transform markets to bring lasting solutions to the most serious environmental problems. EDF has more than 340 scientists, economists, lawyers and other professionals working in offices around the world including in the USA, Mexico, and China. We also work extensively with partner organizations in Brazil, India Vietnam, and other locations.
2. In the late 1980s, [EDF conceived and played a crucial role](#) in the design of the highly successful cap and trade program for reducing sulfur dioxide emissions in the United States. The program, enacted in the 1990 Clean Air Act Amendments, [drove acid rain emissions between 1990 and 2008 down 50%](#) while America's GDP and electricity consumption continued to climb; the program achieved its goals three years ahead of schedule at 20-30% of the estimated cost. In 1996 EDF helped design a proposal for the UNFCCC for combining multi-year greenhouse gas emissions budgets and emissions trading that formed the core of the Kyoto Protocol on climate change. In the late 1990s, EDF warned that poor design features in a U.S. regional NOx trading program risked compromising the program's economic and environmental integrity; the program failed in mid-2000. In 2003, with Brazilian partners, we formulated and presented to UNFCCC negotiators the concept of "compensated reductions" of deforestation, leading to the adoption of [Reducing Emissions from Deforestation and Degradation \(REDD\)](#) in the official UN negotiating agenda in 2005. Our Oceans Program promotes the use of "catch shares" (individual transferable quotas) to help manage fisheries – an approach pioneered in New Zealand that is being adopted around the world. We have long advocated for a national cap-and-trade scheme for greenhouse gases in the US. We helped design and support the California climate program, to which a cap-and-trade

scheme is central, in the state legislature and then helped to defend it from proposals to defer it in November 2010. We strongly support the goal of reducing global emissions in order to keep increases in global temperature below 2 degrees Centigrade over pre-industrialized levels, consistent with averting 'dangerous anthropogenic interference with the climate system.'

3. Our experience shows that market-based solutions to environmental problems, like New Zealand's Emissions Trading Scheme (ETS), can -- if well-designed and implemented -- achieve environmental outcomes in a highly cost-effective manner. Like New Zealand, we realize that the only solution to climate change is a global solution; we are continuing to participate actively in efforts to achieve an international climate agreement. We believe that linking national efforts through international carbon markets is a crucial part of the global solution, because it will encourage more nations to participate in the mitigation effort, help lower the cost of reducing global greenhouse gas emissions, and spur the innovation that is essential to success in tackling the global warming problem.

EDF's submission

4. EDF is making this submission to the Review of New Zealand's emissions trading scheme because we believe that what happens in New Zealand can make a real difference to the global response to climate change. Historically, New Zealand has initiated important policy innovations that have been adopted around the world over time, from female enfranchisement to fisheries quota management systems. Again, the world is watching New Zealand as it implements its national ETS.
5. Our submission focuses on recent developments in international carbon markets, and suggests some factors that New Zealand policy-makers may wish to consider in designing the ETS for the post-2012 environment. It aligns with the first area for focus in the Review's Terms of Reference.¹
6. In relation to the issues statement consultation questions, this submission focuses on questions 6(b), 11, and 12 (e and f).

New Zealand's policy

7. The stated purpose of the ETS is to assist 'New Zealand to meet its international obligations' under the UNFCCC and the Kyoto Protocol.² Under NZ's Climate Change Response Act, the ETS is open to many types of international carbon units (Kyoto units up to 2012, and potentially other units thereafter) and intended to link with other trading schemes over time.³ As the issues statement observes, this open architecture will 'ensure that New Zealand's price reflects international prices and allows ETS participants greater flexibility as to how they meet their ETS obligations'. EDF supports

¹ The terms of reference requires the Review Panel to 'focus on the high-level design of the NZ ETS, giving particular attention to ... a. Priority issues and questions for key NZ ETS design settings arising from possible international frameworks post 2012, and considerations that government might apply in developing a response'.

² Climate Change Response Act, 3(1)(b).

³ 160(5).

this open architecture, which will help lower the cost of meeting New Zealand's responsibility targets for 2020 and 2050. It will also make it more feasible to take on more ambitious targets over time should the Government choose to do so.

8. As the issues statement observes, the design of the ETS is underpinned by the Kyoto Protocol international framework.⁴ One of the key challenges in preparing the NZ ETS for the future is the uncertainty about the post-2012 international framework.
9. In an effort to provide useful information to New Zealand policy-makers during this review, this submission addresses the following issues: What ETS design features help promote NZ's national interests post-2012, given the uncertainty over the international framework? What might the Government need to consider in developing a response to international developments in the carbon market?

Recent developments in carbon markets

10. As the issues statement observes, there is no guarantee that the post-2012 international carbon market will look like the current Kyoto Protocol regime. The statement sketches three scenarios, all of which are possible: first, a 'legally binding multilateral framework'; second an 'international political accord'; and third, 'medium-term uncertainty'. As noted above, EDF is working towards a 'legally-binding multilateral framework.' However, based on recent developments in the evolution of the international carbon market, it appears prudent to elaborate on the second and third scenarios, and consider how best to design the New Zealand ETS so as to maximize environmental and economic integrity while maintaining the flexibility to enable the ETS to respond to any of the three scenarios.

Developments in the USA – setback federally, but moving ahead in California

11. It is not likely that cap-and-trade legislation will be considered by the US Congress in the near term, though we believe it remains the most appropriate alternative for addressing US greenhouse gas emissions over the longer term. In the meanwhile, the US is taking a number of steps to reduce GHG emissions using existing legal authorities at the federal, state and regional level. For example, the US Environmental Protection Agency is under court-ordered deadlines to issue regulations addressing GHG emissions from large power plants and from petroleum refineries in the next two years (EDF is a party to the power-plant litigation).
12. California is pressing ahead with plans to implement a cap-and-trade scheme commencing in January 2012. This decision was reaffirmed by a referendum last November, in which a strong majority of California voters endorsed the Californian policy approach, despite a concerted opposition campaign. This past March 18, in response to a suit by some environmental justice organizations, a Superior Court judge in San Francisco ruled that California created its plan to implement its climate law, AB 32, including the decision to pursue cap-and-trade, without adequately studying policy alternatives. This ruling will probably require that more analysis be completed and

⁴ Par 80.

approved by the Court, but any requirements should be defined and addressed in time for the start of cap-and-trade along with other AB 32 programs in January 2012.

13. The California program is likely, at the outset, to allow use of certified offsets originating under one of four protocols developed by the Climate Action Reserve, a non-profit stakeholder-based organization, and pre-approved by the California Air Resources Board. These protocols cover North American projects performing 1) reforestation and afforestation from forest projects 2) urban forestry, 3) domestic ozone depleting substance destruction and 4) methane reduction from manure management operations. Other new North American project protocol types are being developed and will likely be approved for acceptance in the California program during the first compliance period. Further, California is considering sectoral credits from developing countries – including credits for [Reducing Emissions from Deforestation and Degradation \(REDD\)](#) - under situations where specified agreements are reached between California and foreign jurisdictions. California has already entered into a formal Memorandum of Understanding with the Brazilian state of Acre and the Mexican state of Chiapas. Such policies are likely, over time, to allow sub-national REDD credits to be translated into credits eligible to be tendered for compliance in the California market. California policy-makers also understand the benefits of deepening their carbon market by linking with other markets, and are actively considering ways to allow linkages with the Western Climate Initiative (WCI) members and the EU ETS.
14. Along with California, the Canadian provinces of British Columbia, Ontario and Quebec – which are WCI members and which accounted for 46% of Canada’s greenhouse gas emissions in 2008 – are planning to launch cap-and-trade systems in 2012. (An additional six state and provincial governments that are also participants in WCI have either announced delays in the process or are undergoing internal reviews of the feasibility and timing of launching carbon markets.)

The European ETS – restrictions on units, and a tighter cap

15. The EU ETS remains the world’s largest established carbon market. Because the EU is, like New Zealand, a Party to the Kyoto Protocol, its rules governing offsets align closely with those operating in New Zealand. However, the EU has recently decided to restrict the flow into its system of Kyoto credits under the Clean Development Mechanism resulting from projects in large-emitting developing countries, and from projects that destroy hydrofluorocarbons (HFCs). This policy change reflects the fact that, regardless of developed-country emission reductions, the goal of keeping warming below 2 degrees Centigrade cannot be achieved if the largest-emitting developing countries only participate in projects that earn ton-for-ton tradable credits for reducing emissions below business-as-usual growth trajectories.

The Australia carbon price mechanism

16. On 24 February 2011, the Australian Multi-Party Climate Change Committee released a framework describing a carbon price mechanism. It contemplates a policy framework similar to New Zealand’s: an initial fixed price phase, moving to a flexible price emissions trading scheme as early as 1 July 2012. The framework indicates that international offsets may not be used during the fixed price phase, but international

offsets meeting 'appropriate criteria' could be used for compliance during the flexible price phase.

REDD credits

17. In addition to the possibility of the Californian scheme accepting REDD credits, discussed above, the EU is also considering in what circumstances it would accept REDD credits into the EU ETS. EDF advocates for acceptance of REDD credits where the following criteria are met: (i) a clear and robust accounting system to measure performance at jurisdiction-wide level(ii) ; appropriate consultation with stakeholders; (iii) a registry established to track transactions and prevent double counting; and (iv) real jurisdiction-wide reductions below historical emissions. EDF believes that opening carbon markets to such credits offers what may be the most important near-term opportunity to preserve options for keeping warming below 2 degrees Centigrade.

Other developments

18. Other greenhouse gas emissions trading systems in operation include the Regional Greenhouse Gas Initiative (RGGI) in the northeastern US, Alberta (Canada), New South Wales (Australia), Switzerland, and the city of Tokyo, Japan. South Korea and Japan have proposed emissions trading systems that could be implemented in the near term, and various countries, including China, are in planning or active exploration stages. W
19. With the adoption of a law in December 2009, Brazil became one of the first major economies to adopt a national, economy-wide emissions reduction target independent of the international negotiations. Based on further regulations from December 2010, Brazil's target implies an absolute reduction of total emissions of between 6 to 10% below its reported 2005 emissions by 2020. In December of 2009, the state of Sao Paulo in Brazil adopted an even more ambitious absolute target of reducing emissions by 20% below 2005 levels by 2020. Strategies for meeting these goals are currently being developed, and both the national and Sao Paulo laws include the option of potentially using an emissions trading system. Brazil's economy-wide climate law also encompasses a national plan to reduce deforestation in the Amazon by 80% by 2020 relative to a historic (1996-2005) average. The government of Norway has committed \$1 billion to support this effort. Between 2005 and 2010, Brazil has already nearly met this goal, reducing deforestation emissions by about 1 billion tons of CO₂. These reductions are on the scale of those the United States and the European Union have pledged for 2020.⁵

How carbon markets might develop post-2012

20. EDF strongly supports efforts to reach a binding international agreement at the next UNFCCC meeting in Durban, South Africa in November 2012, with further binding commitments from developed countries, and new market mechanisms allowing

⁵ Boucher, Doug. 2011. "Brazil's Success in Reducing Deforestation." Briefing #8, Union of Concerned Scientists, Washington, DC. http://www.ucsusa.org/assets/documents/global_warming/Brazil-s-Success-in-Reducing-Deforestation.pdf.

developing countries to build their domestic efforts into a unified international carbon market based on the new binding international agreement. There are, however, significant challenges to the UNFCCC reaching this outcome. Given the carbon market developments parallel to the UNFCCC detailed above, it seems prudent for New Zealand policy-makers to have a clear idea of how the second and third scenarios might unfold in relation to carbon market development, to ensure that the first scenario provides opportunities for new countries to form domestic carbon markets, and to address proactively the opportunities and threats that each of these scenarios entail.⁶

Carbon market development under the second and third scenarios

21. Under the second and third scenarios, carbon markets will develop in domestic jurisdictions. As this occurs, each domestic jurisdiction will need to decide the terms upon which it will (a) link to other jurisdictions' markets, and (b) allow offset credits into its jurisdiction from other jurisdictions, whether those have their own carbon markets or not. In order to promote the widest possible innovation, offer the broadest possible competition among low-carbon alternatives, and thereby reduce the overall cost of the abatement effort, a jurisdiction developing carbon markets will have a strong incentive (a) to encourage domestic sectors that are not participating in emissions caps to earn offset credits for reducing emissions below what would have otherwise occurred; (b) to allow linkage with other jurisdictions having comparable carbon market programs; and (c) to allow offset credits from other jurisdictions to be tendered for compliance in its own program. Thus, it is likely that in the second and third scenario, domestic carbon markets will accredit and draw in various types of offsets from their own uncovered sectors, as well as allowances and offsets from other jurisdictions (including REDD credits).
22. Jurisdictions developing the largest carbon markets may become the *de facto* designers of bilateral linkage mechanisms and international offset standards. These standards may spread broadly, as countries subsequently moving to link to these larger markets will need to adopt compatible linkage and offset rules. For example, if New Zealand seeks to link to a larger carbon market which restricts the use of HFC credits, like the EU ETS, or a scheme which does not allow the use of any CDM credits, it may be required to adopt similar restrictions.

Opportunities and threats

23. EDF believes this decentralizing trend in the design and development of markets, market linkage, and offsets creates both opportunities and threats. A key concern will be to balance the imperative for broadening linkages and accrediting new offsets with the necessity of ensuring environmental integrity. Carbon markets should serve as engines of innovation and forces for reducing the cost of global abatement, thereby allowing more ambitious national targets to become feasible; environmental integrity of the markets is a critical precondition to achieving the environmental goals for which

⁶ Options for building these opportunities are discussed in: Petsonk, Annie. 2009. "Docking Stations": Designing a More Open Legal and Policy Architecture for a Post-2012 Framework to Combat Climate Change," *Duke Journal of International and Comparative Law* 19(30): 433-466. <http://www.law.duke.edu/journals/djcil/djciltoc19n3>.

they are designed. EDF has made a joint submission to the UNFCCC on these issues,⁷ highlighting the need for strong requirements for environmental integrity; rapid transition to sector-wide caps; and a level of national ambition consistent with preventing ‘dangerous anthropogenic interference with the climate system’.

24. A key opportunity (likely to arise in particularly the third scenario) not considered in the issues statement is to use the New Zealand ETS to develop new types of linkages that incentivize and reward stronger industrialized and developing country action. New Zealand’s ETS is designed to support and encourage ‘global efforts to reduce greenhouse gas emissions’.⁸ By establishing criteria by which both industrialized and developing countries may ‘dock’ into New Zealand’s domestic carbon market, New Zealand and other carbon market jurisdictions can encourage other industrialized countries – including, someday, the United States – and developing countries to expand and extend their mitigation efforts, broaden carbon markets, and can simultaneously provide valuable experience in linkage and offset design.
25. The following elements are essential to ensure environmental and financial integrity and capacity for nations docking into carbon markets:⁹
 - **An absolute, legally enforceable commitment by docking nations to reduce emissions on a sectoral or broader-scale basis.** Such commitments can be calculated on the basis of a historical base year or years, and can be sectoral, multi-sectoral or economy-wide, as well as national or sub-national in scale. Emissions targets can be legally enforceable either through international agreements or as a matter of domestic law.
 - **Access to global carbon markets,** providing capital and investment flows at the scale necessary to finance low-carbon economic development—while driving innovation and deployment of new technology.
 - **A filter mechanism to protect the environmental integrity** of the core global trading system. Access to the global system can be tied to rigorous quality reviews of a docking nation’s capacity to measure and monitor emissions.
 - **A phasing mechanism** with clearly established rules and criteria that gradually raise the level of commitment for countries.
 - **Capacity-building** to enable nations to dock into carbon markets swiftly and with integrity.
 - **Stability and predictability of rules-based frameworks,** i.e., changes to market rules are made infrequently, in accordance with pre-announced procedures, and following opportunities for public input, so that private-sector participants in

⁷ Natural Resources Defense Council, EDF and the Union of Concerned Scientists. “Comments on the development of new market mechanisms pursuant to Cancun Agreements,” (submitted 22 February 2011). <http://unfccc.int/resource/docs/2011/smsn/ngo/237.pdf>.

⁸ Act, section 3(1)(b).

⁹ “Docking Stations: Welcoming nations into greenhouse gas cap-and-trade markets,” Environmental Defense Fund. Washington, DC. http://www.edf.org/documents/10484_Docking_Stations.pdf.

particular will have the confidence to make the long-term investments needed for durable low-carbon development.

26. A key early example of this approach is the SIDS Dock proposal, championed by the Alliance of Small Island States (AOSIS), including many of New Zealand's Pacific neighbors. The proposal aims to help the island nations transition to sustainable, low-emission energy technologies by aiming to increase energy efficiency by 25 percent (2005 baseline), generate a minimum 50 percent of electric power from renewable sources, and generate a 20-30 percent decrease in conventional transportation fuel use by 2033. In Cancun, AOSIS, the Government of Denmark, the World Bank and the United Nations Development Programme announced plans to support this proposal, which could connect the islands' mitigation efforts with the EU and US carbon markets. REDD credits are another example of a new instrument representing legitimate mitigation effort in need of a market to provide incentives. Over time, credits representing mitigation in developing country agriculture may be developed, and New Zealand's undoubted expertise in this area could play a critical role in proving up these new instruments, as well as providing a marketplace. Opening the New Zealand ETS to this or similar initiatives is a way to help encourage the development of the international carbon market and broadening mitigation effort.
27. New Zealand policy-makers should be aware of two longer-term potential pathways in linking carbon markets. The first is a pathway through which those jurisdictions that undertake carbon markets (e.g., the EU, California, New Zealand) might coordinate their approaches to market linkage, developing common criteria that other jurisdictions might meet in order to link to theirs. The second pathway is one whereby the ambition of New Zealand's national mitigation effort (including its 2020 and 2050 targets) may become a factor. Initially, decisions by market designers (in the EU, California and elsewhere) to link to other nations' markets and to accredit other nations' sectoral efforts (such as REDD) will depend on several factors, including the integrity of the other nation's market and offset programs, as well as judgments about whether the other nation is undertaking an appropriate level of mitigation effort in the sector (i.e., is the sector making real progress in reducing emissions?). Over time, the same logic may demand that such nations' ambitions correspond to a 'fair share' of the global mitigation effort before domestic schemes can be linked; that is, market designers may examine and judge New Zealand's mitigation effort, in particular whether it represents a fair share of an ambitious global abatement effort, before they agree to link. Both of these trends parallel market linkage developments that have occurred as the General Agreement on Tariffs and Trade evolved into the World Trade Organization. Noting trends in the WTO, it is less likely, but not impossible, that over time decisions to link carbon markets might examine not only overall national mitigation efforts, but also national policy settings, such as whether allocation policies effectively and efficiently address competitiveness issues.

Factors to consider in designing NZ ETS for post-2012:

28. Based on the analysis above and New Zealand's stated policy objectives, EDF suggests the following factors are relevant to designing the NZ ETS for the post-2012 period.

- **Flexibility and adaptability** will be critical, given the uncertainties about the international framework post-2012. The current legislation allows regulatory discretion over the accreditation of overseas units; maintaining this flexibility will enhance NZ's ability to balance its policy objectives regardless of how the international framework evolves;
- **Continued access to other carbon markets** will be important, to allow New Zealand to maintain its international good standing by continuing to meet its responsibility targets, while balancing the need for an orderly transition to a lower-carbon domestic economy. A domestic-only market (contemplated in paragraph 93) would make it much more difficult to meet internationally agreed targets;
- **Ongoing development of other carbon markets** will allow New Zealand, over time, to achieve its international targets at lower cost. New Zealand has stated its interests in broadening and deepening the carbon market in several UNFCCC submissions.¹⁰ New Zealand may wish to consider ways in which it can use its ETS to promote the broadening of the carbon market, for example by participating in trials which support and encourage developing countries' mitigation efforts, such as SIDS Dock, or by allowing suitably accredited REDD credits to be used for compliance. Given that international carbon market development is proceeding in parallel through the UNFCCC and through carbon market design in California, the EU, Australia, and potentially other nations and regions, New Zealand may wish to consider how best to stay abreast of these developments, and how best to contribute its own insights.
- **Maintaining control and flexibility over the types of offsets which can be admitted into the New Zealand ETS** will help New Zealand respond to uncertainties in the post-2012 framework. Linking with other carbon markets or evolving UNFCCC frameworks may require New Zealand to admit or prohibit certain types of offsets into its scheme, and it seems advisable to maintain the means to do so.
- **Environmental credibility of the market and its instruments is crucial** – carbon markets are designed to achieve an environmental goal, and should remain subject to the environmental imperative. New market mechanisms should be subject to strong environmental integrity requirements, including the ambition of domestic mitigation actions.

29. Some might argue that developing and extending its domestic carbon market in the absence of a new multilateral framework might place New Zealand at a competitive disadvantage in the event that other nations, particularly New Zealand's major trading partners, do not follow New Zealand's lead. Some might also argue that "leakage" from the New Zealand ETS could undercut the benefits of New Zealand's leadership efforts. However, careful application of the five factors listed above can allow New Zealand to

¹⁰ See, for example, Government of New Zealand, Submission to the AWG-LCA, February 2011: 'Views on various approaches, including opportunities for using markets, to enhance the cost-effectiveness of, and to promote, mitigation actions, bearing in mind different circumstances of developed and developing countries', UNFCCC document FCCC/AWGLCA/2011/MISC.2; March 2011.

implement a domestic policy that encourages and welcomes other nations to join New Zealand in pursuing low-carbon development using the most powerful engine available -- carbon markets -- while at the same time enabling New Zealand to nurture home-grown, low-carbon, high-efficiency technologies and processes that New Zealand can then market to other nations around the world. For example, New Zealand has decided to bring its land-use sectors into its domestic carbon market. Other jurisdictions with significant emissions from land use and land-use change would have much to learn from New Zealand's experience in this area, and might seek New Zealand expertise in developing and implementing comparable programs for their domestic sectors.

30. Following the five factors noted above can also position New Zealand well for coordinating on carbon market access issues with those other jurisdictions that have already developed carbon markets, and those that are considering doing so. In the event that the global community is able to agree on a multilateral carbon market framework, New Zealand's experience will significantly inform the shaping of that framework. But if the global community cannot reach such an agreement, New Zealand's experience will be invaluable in shaping plurilateral carbon market access conditions among those jurisdictions that choose to go ahead.

Respectfully submitted,
Environmental Defense Fund
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By:
Jennifer Haverkamp
Director, International Climate Program
jhaverkamp@edf.org