Linking issues for NZ's proposed Emissions Trading System

Tim Denne

30th November 2007

© Covec Ltd

Issues

- Principles
- NZ unit of trade
- Limits on entry
- Limits on sales
- Impacts of price caps
- Linking with Australia

Starting point

covec
expert analysis + practical advice

- Linking is essential – NZ needs to purchase units
- Want to link in a way that enables Kyoto compliance at least cost
- Environmental integrity important, but this is largely achieved through the international agreement, not domestic policy
- NZ a small player. Liquidity will be set in international market, not NZ market. Want to maximise access of NZ firms to units.

Unit of Trade

- Decision at this stage to introduce separate unit: an NZ unit (NZU)
- NZUs will be fully backed by Kyoto units by the end of the true-up period
- Allows the government to issue NZUs to forestry companies prior to receiving RMUs
- Gives some additional ability to set specific rules re trading of NZUs

Linking

- In principle, obligated parties would be able to purchase and bring into the NZ registry, any Kyoto-compliant unit they can obtain
- CERs and ERUs – relatively straightfoward
- AAUs – less so
  - Might require bilateral arrangement with another ETS. EU may not be possible because of inclusion of forestry, although may be possibility of one-way linking (buy only)
  - Exploring possibility with other schemes
  - Availability of other AAUs is unclear

Limits on entry

covec
expert analysis + practical advice

- The starting principle is, if it’s Kyoto compliant, let it in
- Supplementarity will not be used to restrict entry
- Some <u>possible</u> restrictions
  - Nuclear-based CERs or ERUs – previous policy rules out
  - tCERs and lCERs (forestry-based CERs)
  - HFC-23 projects (environmental integrity concerns)
  - ‘hot air’ AAUs

"Hot air" AAUs

- The decision to create 'hot air' was made with full knowledge at Kyoto
- Concern that not allowing them provides a poor signal to other potential entrants
- Decision for NZ to let in 'hot air' AAUs balances potential for low cost units with potential restriction on <u>sales</u> to other markets
- But NZ likely to be a net <u>buyer</u>
- Restrictions on sales from NZ may reduce liquidity, but won't have a significant price effect

Limits on Sales

- Commitment Period Reserve is binding on transfers out
- Otherwise, no restrictions, except those defined in other markets

Price caps

- Price caps have been raised in consultation as a protection mechanism against international price volatility (or level)
- Most simply—unlimited supply of NZUs at a fixed price
- NZ government would still need to bring NZ into compliance, so there would need to be restrictions on international sales (or it would provide a price cap to the world)
- Reluctance at this stage to introduce such a mechanism

Linking with Australia

- Outside-Kyoto
  - One-way only (in net terms)
- Inside Kyoto
  - Easy!

expert analysis + practical advice

Tim Denne
Covec Ltd

tim@covec.co.nz
www.covec.co.nz