

Peter Wilson¹

To Harmonise Or Not To Harmonise, Should That Be The Question?

Emissions Trading Schemes in New Zealand and Australia

An Anzac approach?

The governments of New Zealand and Australia are proposing to implement greenhouse gas emissions trading schemes (ETS) to help drive down carbon pollution within their borders. Although both countries enjoy a political consensus in favour of emissions trading, the Parliament of each country is deeply divided along party political lines about the appropriate design of their respective schemes.

Peter Wilson is Group Manager Climate Change at Vector Limited. He manages Vector's group strategy, policy and specific initiatives related to climate change and energy emissions. Peter joined Vector in 2008 after 17 years with the Treasury, where his last assignment was with the Emissions Trading Group. He was responsible for providing advice to ministers on scheme design and leading the team that prepared the legislation introducing the ETS.

Following calls from certain sectors of New Zealand industry to harmonise the two schemes, a trans-Tasman working group of New Zealand and Australian officials was established in March 2009 to consider the question of harmonisation. Apparently in advance of this group concluding its work, in September 2009 the New Zealand government announced a series of unilateral amendments to the New Zealand ETS, designed in part to align the New Zealand ETS more closely with Australia's.

This article examines the case for harmonisation – defined as making regulatory requirements or government policies of different jurisdictions identical or at least similar (Leebron, quoted in Quigley, 2003, p.3) – along with the legal and institutional issues that arise. It concludes that the economic case for full harmonisation is not made, although linking the two schemes – allowing emissions units issued by one country to be used to comply with the scheme operated by the other – might provide some economic benefits. Notwithstanding these benefits, the legal and institutional issues involved with linking mean that even that level of harmonisation will be difficult to achieve in the short term, particularly in the midst of contentious political debate occurring on both sides of the Tasman.

Accordingly, I question whether it is the right time to be considering harmonisation, and posit that both countries should focus on designing and implementing their respective schemes first.

The article firstly outlines why Australia and New Zealand are undertaking action to reduce greenhouse gas emissions and what they have done to date. It then summarises the emissions trading schemes proposed in both countries, and in the following section discusses the principles underlying cross-border policy cooperation and applies those principles to emissions trading.

The context: why Australia and New Zealand are both proposing emissions trading schemes

Because greenhouse gases emitted from one point are quickly and evenly mixed through the atmosphere, there is no direct link between local actions (which can incur costs) and local impacts. This means that any benefits of mitigation are always shared globally. This disjuncture between costs and benefits makes climate change a diabolical policy problem (Garnaut, 2003, p.viii). The world as a whole will be better off if there is significant mitigation of the harmful effects of climate change, but every individual country also has a clear incentive to let others bear the burden of that mitigation, while reaping the benefits.

Overcoming these sorts of diabolical policy problems is difficult and to date the world has not ‘solved’ the problem of climate change. But we do have some experience in dealing with complex international problems, which suggests that communication and undertakings to share the gains, all undertaken repeatedly, with slow steps forward, building trust and cooperation, are important parts of the process.

When viewed outside the context of a global negotiation, an individual country taking costly mitigation action can seem irrational. It is commonly noted by opponents of mitigation action that New Zealand’s small size (accounting for about 0.2% of total greenhouse gas emissions in 2006) means that any contribution that it makes to global mitigation efforts will

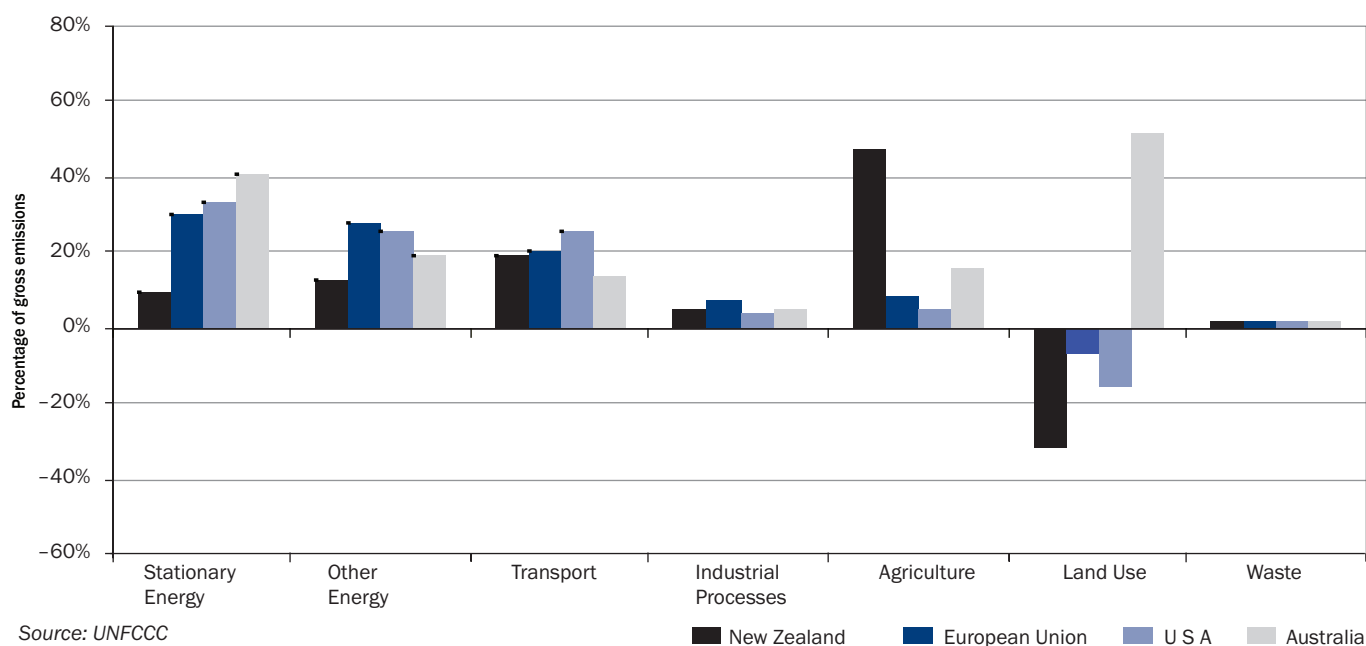
be miniscule. While Australia has larger absolute emissions, even it contributes only about 1.45% to the global total of emissions.² In comparison, China contributes over 19% of global emissions, and the United States 18.5%. The next largest emitters are Russia, with 5.2%, India at 4.9% and Japan with 3.6%. Australia ranks 17th and New Zealand 57th. Even reducing emissions in both Australia and New Zealand to zero, if taken in isolation would not have any discernable impact on the risks facing the planet. Indeed, combined emissions for the two countries in 2006 equalled less than one half of the increase in global emissions from 2005 to 2006.

But neither Australia nor New Zealand is joining global efforts to address climate change because of the size of its contribution to those efforts. They are joining those efforts because of the judgement that concerted action by the developed world to address this issue is required to induce the developing world to also make an appropriate contribution.

The logic runs like this. The only way to reduce the total concentration of greenhouse gases to prudent levels is for all countries to make a contribution. This is both a matter of maths – not even the biggest emitters, like China and the US, are large enough that their unilateral actions, especially in the short term, will have a significant effect on climate change – and a solution to the free-riding problem. ‘All countries’ includes the so-called BRIICs (Brazil, Russia, India, Indonesia and China). The only way the BRIICS will agree to this is if the developed world agrees to make major reductions in its level of emissions, first.

This subtle game of bringing the diverse nations of the world together into an agreement that overcomes the incentive to free-ride can be seen in the language of the existing international agreements and the process of negotiating new agreements. The United Nations Framework Convention on Climate Change (the UNFCCC) has as its ultimate

Figure 1: Agriculture dominates in New Zealand, energy in Australia



objective the stabilisation of greenhouse gas concentrations in the atmosphere at a (unspecified) level that would prevent dangerous man-made interference with the climate system. To meet this objective, countries agreed to be bound by the principle that they should act on ‘the basis of equity and in accordance with their common but differentiated responsibilities and respective capabilities’. They have also explicitly agreed to the principle that developed countries should take the lead in combating climate change. The Bali Action Plan, agreed to at the United Nations climate talks in December 2007, repeats these principles. In deciding to launch action to reach a new international agreement, the parties agreed to consider requiring all developed countries to accept measurable, reportable and verifiable nationally appropriate mitigation commitments and actions. Developing-country parties would be required to undertake less stringent actions.³

The reasoning that mitigation policies of developed countries are directed at supporting international negotiations finds expression in the purposes clauses of the legislation establishing the Australian and New Zealand emissions trading schemes.⁴

Patterns of emissions

While there are similarities in the objectives Australia and New Zealand have set for their emissions trading schemes, they start from very different positions when it comes to the nature of emissions in each country.

Figure 1 compares the proportions of emissions coming from different sectors across New Zealand and Australia in 2007, with the European Union and the US included for comparison purposes. For New Zealand, agriculture is by far the largest source of emissions, while land use (principally forestry) offsets a large proportion of our gross emissions. In Australia, stationary energy – principally coal-fired electricity – is the major source, while land use has a variable effect on the total. In 2007, emissions from this sector were high and positive.

The story so far

In ratifying the UNFCCC, both Australia and New Zealand entered into commitments to implement measures to mitigate climate change by addressing man-made emissions within their borders. Despite a number of statements of intent to introduce policy measures, it was not until 2007 that the then New Zealand government introduced, and eventually passed (in September 2008), legislation for an ETS. The current government has introduced legislation that seeks to amend some of the core provisions of the ETS, especially in the early years of the scheme’s operation. While a majority of Parliament supported this bill in its first parliamentary stages, to date there has not been a public commitment from a majority of MPs to pass the bill.

Australia has also taken a long time to implement any significant market-based mechanisms to address climate change. A package of 11 bills for the Carbon Pollution Reduction Scheme (CPRS) was passed by the House of Representatives on 4 June 2009. On 13 August the Senate voted against the bills. The government has indicated that it intends to reintroduce the bills before the end of 2009. At the time of writing, it is unclear whether, and in what form, Australia will introduce its scheme.

Emissions trading in Australasia

The idea behind emissions trading is that by setting limits on emissions or any other undesirable activity but allowing individuals to use market mechanisms, technologies and preferences to drive eventual outcomes, the problem being addressed will be corrected in a less costly manner than would be the case with government regulation. The core requirement of each scheme is the same. Each emitter (or deemed emitter in some cases, like miners of natural gas) is required to measure, record and report their emissions. For each tonne of greenhouse gas emissions, they must hold one ‘emissions unit’. These units are costly and can be acquired from the government, either at auction or for free as part of a transitional assistance programme; purchased from the market; or earned by undertaking activities that remove gases from the atmosphere.

Table 1 outlines and compares the main provisions of the schemes proposed in Australia and New Zealand. Significant differences are italicised. For New Zealand, two columns are presented: the first sets out the emissions trading legislation as enacted in late 2008, while the second shows the major changes proposed in the Climate Change Response (Moderated Emissions Trading) Amendment Bill.

In ratifying the UNFCCC, both Australia and New Zealand entered into commitments to implement measures to mitigate climate change by addressing man-made emissions within their borders.

The special role of the Kyoto Protocol

Both Australia and New Zealand have proposed to integrate their schemes, at least to some extent, with the Kyoto Protocol. The Protocol does not require parties to exclusively meet their targets by constraining the level of emissions within their borders. A developed country can meet its target by a combination of:

- reducing net domestic emissions (gross emissions less removals though forestry);⁵
- using an unused part of another country’s target (emissions trading);

Table 1: Summary of the Australian and New Zealand schemes

Feature	New Zealand – current act	New Zealand – proposed changes	Australia
Core provisions			
Gases	All greenhouse gases	No change	All greenhouse gases
Sectors (and date of entry)	Stationary energy (2010), transport (2011), industrial processes (2010), waste (2013), agriculture (2013), forestry (2008)	Entry of the stationary energy and industrial processes sectors deferred six months. Entry of transport brought forward six months. Entry of agriculture deferred to 2015	Stationary energy, transport, industrial processes, waste, <i>fugitive emissions, reforestation</i> (all 2011). <i>Consideration of introducing agriculture will take place beginning 2013, with entry not until 2015 at the earliest.</i>
Estimated coverage	~ 100% of emissions	No change	~ 75% of emissions
Number of firms with compliance obligations	200 in energy, transport and industrial processes. Up to 10,000 forestry participants, although participation for those owning forests planted after 1989 is voluntary. If agriculture applies at the farm level, there could be up to 15,000 entities covered.	No change	1,000 entities
Point of obligation	<i>Mostly upstream. Agriculture could be either upstream (at the processor level) or downstream (farm level).</i>	No change except in agriculture, where the presumption that point of obligation will be at the processor level is made stronger.	<i>Mixed upstream and downstream point of obligation</i>
Openness to international carbon markets	Open to (most) Kyoto units	No change.	Open to (most) Kyoto Units, <i>eventually</i>
Price path	<i>International prices</i>	<i>Fixed price, then international prices.</i>	<i>Fixed price, then capped price, then international prices</i>
Transitional assistance			
Assisted sectors	Pre-1990 forest, industrial processes, fishing and agriculture. For industrial processes, there is a trade-exposure test.	Transport and energy sectors to be given a price reduction.	Industrial processes and <i>stationary energy</i> . For industrial processes, there is a trade-exposure test.
Type of assistance	Free allocation of units	Transport, industry and energy sectors provided with a 'progressive obligation'. Requirement in the first three years is to surrender one unit for every two tonnes of emissions.	Free allocation of units
Quantum of assistance	Varies from sector to sector, but in all cases total level of assistance to a sector <i>is fixed, based on historical emissions.</i>	Move to Australian system.	<i>Open-ended, depending on future level of emissions.</i>
Timing of assistance	Generally, phased-out linearly from 2019 (first year of reduced allocation) to 0% in 2030.	Move to Australian system.	Open-ended, but with a 'productivity factor' applying to reduce level of allocation per unit of output.

- financing additional emissions reduction in another developed country (joint implementation); or
- financing emissions reductions in a developing country (the Clean Development Mechanism).

The system of national accounting is based on the issuance and surrender of emissions allowance, collectively called 'Kyoto units'. These units can be transferred between countries via a global registry operated by the United Nations: the International Transactions Log. With some restrictions, some of which apply only during the transitional period, both countries are allowing Kyoto units to be used to meet domestic obligations. One very important implication of this

is that over time it is expected that the price of emissions units on both Australia and New Zealand will converge to the price of Kyoto units.

Linking emissions trading schemes

Both the Australian and New Zealand emissions trading schemes contain provisions allowing parties to surrender emissions units issued under another country's scheme for domestic compliance. In the jargon of emissions trading, this is known as 'linking'. In both cases, linking requires the foreign scheme to be approved by the government. The European emissions trading scheme also includes provisions to allow

linking to other schemes, although no moves have been made to do so as yet. Both the Senate and House of Representatives versions of bills to enact an emissions trading scheme in the US contain provisions to enable linking. If two schemes are linked, decisions made about the price and quantity of units issued in one scheme will have material implications for the government operating the other scheme.

How to harmonise

Harmonising regulations normally means that governments work together to design, implement or operate a policy rather than acting alone, although one country copying the provisions of another country's regulations would fit the definition of 'harmonisation'. The implication is that not only are harmonised schemes the same, but they are different from what would have been constructed through unilateral actions.

There is a wide range of ways in which countries can work together to achieve better policy outcomes than if they act alone. Institutional options for facilitating trans-Tasman regulatory cooperation or harmonisation fall into three broad categories:

- mutual, legally-binding commitments enshrined in a bilateral treaty signed by both parties;
- mutual, non-legally-binding commitments;
- unilateral coordination.

Treaties are legally binding, and once in force are difficult to withdraw from or amend. They therefore provide the highest level of certainty that the parties will meet their commitments, and of the likely outcomes of doing so. Due to this fact, treaty negotiation processes can be lengthy and contentious, as the parties strive to specify their commitments with care.

Political cooperation agreements often take the form of a statement of intention or a memorandum of understanding, and set out the parties' agreement to undertake mutual action. Political agreements are not legally binding like treaties, but do carry a lot of political force because they are essentially promises by one government to another. Not being legally binding, they do not provide the level of certainty that treaties provide, but are often less contentious and quicker to negotiate.

Agreeing to take independent but mutually-coordinated action domestically is similar to a political cooperation agreement but does not involve a formal agreement to do so. As such, it relies entirely on the political will of both governments to undertake the agreed actions. Commitments to take mutually-coordinated domestic actions therefore provide the lowest level of certainty that the parties will meet their commitments, but as they reserve for each party maximum flexibility, they are therefore relatively easy commitments to make.

The form of institutional and operational support required to help the parties achieve and maintain their specified

commitments depends on the nature of the commitments each party makes to the other. There is a wide range of possible support structures, such as:⁶

- co-management/joint regulation, which may include a joint regulatory body;
- consultation, e.g. regular meetings of ministers and/or officials from both governments;
- reviews of existing laws and regulatory arrangements.

Food regulation in New Zealand and Australia provides an example of joint regulation. The two countries have signed a legally-binding treaty⁷ under which both commit to a joint regulatory approach concerning the development of food standards. In order to support these commitments, the Australia and New Zealand Food Regulation Ministerial Council was established. The New Zealand government, the Australian Commonwealth government and each of the Australian state governments have a representative on the council. The council's function is essentially one of governance, with its key functions including policy development and general oversight of the food standards regime. Underneath

Food regulation in New Zealand and Australia provides an example of joint regulation. The two countries have signed a legally-binding treaty under which both commit to a joint regulatory approach concerning the development of food standards.

the council sits Food Standards Australia New Zealand (FSANZ), which is an independent statutory agency charged with undertaking the technical work involved in developing food standards. The agency itself has staff in New Zealand and Australia, and is managed by a Board with a mixture of New Zealand and Australian appointments. Once FSANZ develops food standards, the Council agrees to the standards, after which both governments are obliged to ensure the standard is implemented in their countries. Consultation and reviews at both the political and operational level are also built into the process for jointly developing food standards.

An example of 'lower-key' cooperation is the coordination by the two countries with respect to business law. In 2000, and again in 2006, the governments of New Zealand and Australia signed a memorandum of understanding in which both governments agreed to coordinate to harmonise a wide range of laws affecting business. No new bodies have been established to support these efforts, but there are regular meetings between New Zealand and Australian ministers and officials in the relevant fields. One key mechanism for determining whether and what harmonisation should occur is review of existing laws and regulatory processes. Although not binding, this political agreement has resulted in a range

of business law harmonisation (for example, competition and consumer protection laws), and the work programme for continued harmonisation is extensive.

What instrument is required to specify the parties' harmonisation commitments, and the institutional and operational support required to achieve and maintain the agreed levels of harmonisation, depends on the nature and complexity of the harmonisation commitments. The more mutual and detailed the commitments, the more likely a formal instrument to record the parties' commitments will be needed and the greater the need for robust institutional and operational support to achieve and maintain them.

A commitment to develop a single emissions trading scheme, or to link and enable trading of each others' domestic units, would almost certainly require a formal instrument specifying both parties' respective commitments to make the necessary changes to domestic regulatory settings to achieve the level of harmonisation required. In the case of a single scheme, a treaty would almost certainly be required. A 'linking agreement' may take the form of a treaty, although could possibly also be a non-binding political cooperation agreement.

A single scheme would invariably require one or more joint regulatory bodies, involving actors at both the political and operational levels. Linking may not require a formal joint body to be established, but some form of joint institutional cooperation seems inevitable due to the possibility of unilateral action by one party adversely affecting the other. For example, if the schemes were linked with a price cap at a certain price, or without a price cap, then one country's decision to change the capped price or impose a price cap could have significant implications for the other. You would therefore expect to see some constraints on the parties' decision making, at the very least a requirement to consult the other party before making such decisions.

A lower level of commitment, such as independent but mutual adoption of certain design elements, may not require a formal instrument to specify the parties' commitments or much institutional and operational support. Nonetheless,

Table 2: Institutional arrangements

Option	Nature of commitments	Institutional support
Level 3: Full harmonisation (one scheme)	Reciprocal (treaty)	Joint regulatory body (political and operational)
Level 2: Mutual trade of domestic units (linking)	Reciprocal (treaty or political cooperation agreement)	Joint regulation Regular discussions and consultation
Level 1: Voluntary adoption of key design features	Unilateral (possible political cooperation agreement)	Ongoing consultation likely

even with an informal agreement to carry out mutual action, at least some level of ongoing consultation is likely.

In summary, any option involving mutual commitments to harmonise the two schemes requires consideration of what instrument is required to specify the two governments' commitments to each other, and what, if any, institutional and operational support is required to help the parties achieve and maintain their commitments.

Table 2 summarises the relationship between the degrees of harmonisation, the nature of commitments involved at each main level of harmonisation and the institutional support required.

Why harmonise?

The economic case

Neither government has been particularly forthcoming on why harmonisation of emissions trading schemes is being considered, speaking in vague terms about the potential benefits for firms on both sides of the Tasman, including the reduction of transaction costs. The Australia and New Zealand School of Government, in its publication *Arrangements for Facilitating Trans-Tasman Government Institutional Co-operation*, argues that there should be clarity about the objectives being pursued when considering institutional cooperation. It suggests that common objectives that need to be considered include (emphasis added):

- lower business and other compliance costs and technical barriers to trade;
- increased policy and regulatory effectiveness across borders;
- increased cost effectiveness, policy implementation and enhanced capacity within government;
- increased influence over international policy directions, norms, rules and standards.

It is difficult to see how these objectives are relevant to emissions trading.

While there are some quirks in the international 'rules' regarding emissions sources,⁸ emissions trading per se is not a traditional barrier to trade. Emissions trading generally applies neutrally between domestically-consumed and exported goods.

There are three reasons why harmonisation of emissions trading schemes might, at a conceptual level, be desirable. These are: to reduce compliance costs for trans-Tasman firms; to remove any competitive disadvantage by providing a level playing field; and to avoid so called 'leakage', which occurs when an environmental regulation causes the location of production to shift to a jurisdiction without the regulation.

Compliance costs

Reducing compliance costs is one of the often-quoted reasons for many trans-Tasman and other regulatory harmonisation proposals. The argument is that by having one set of compliance rules, rather than two, firms can comply with regulations at lower overall costs. Because both Australia and New Zealand are proposing to place the point of obligation

of their emissions trading schemes high up the production chain, there will be few firms that actually have compliance obligations in either country. Outside forestry and agriculture, the New Zealand Government has estimated that about 200 firms will have compliance obligations. For Australia, the estimate is about 1,000. But I estimate that there will be only about 10 firms with compliance obligations in *both* countries. All of these are large multinational companies with extensive resources and expertise available to them. They are the sorts of firms that tend to be good at compliance.

So, having one set of compliance rules will be of limited benefit. What about the costs? There is no guarantee that any harmonised rules will be simpler than those currently proposed. Neither Australia nor New Zealand have particularly good reputations when it comes to producing low-cost regulatory regimes. And at the risk of sounding parochial – and bearing in mind the role I played in designing the New Zealand emissions trading scheme – I do think that the proposed New Zealand scheme looks simpler to comply with than the Australian system.

I see a real risk that, from the point of view of New Zealand firms without trans-Tasman compliance obligations, harmonisation would lead to greater costs than the counterfactual of a scheme designed and operated domestically. And as I note elsewhere, the process of harmonisation can erect barriers to the swift amendment of rules if improvements are required. I would also be

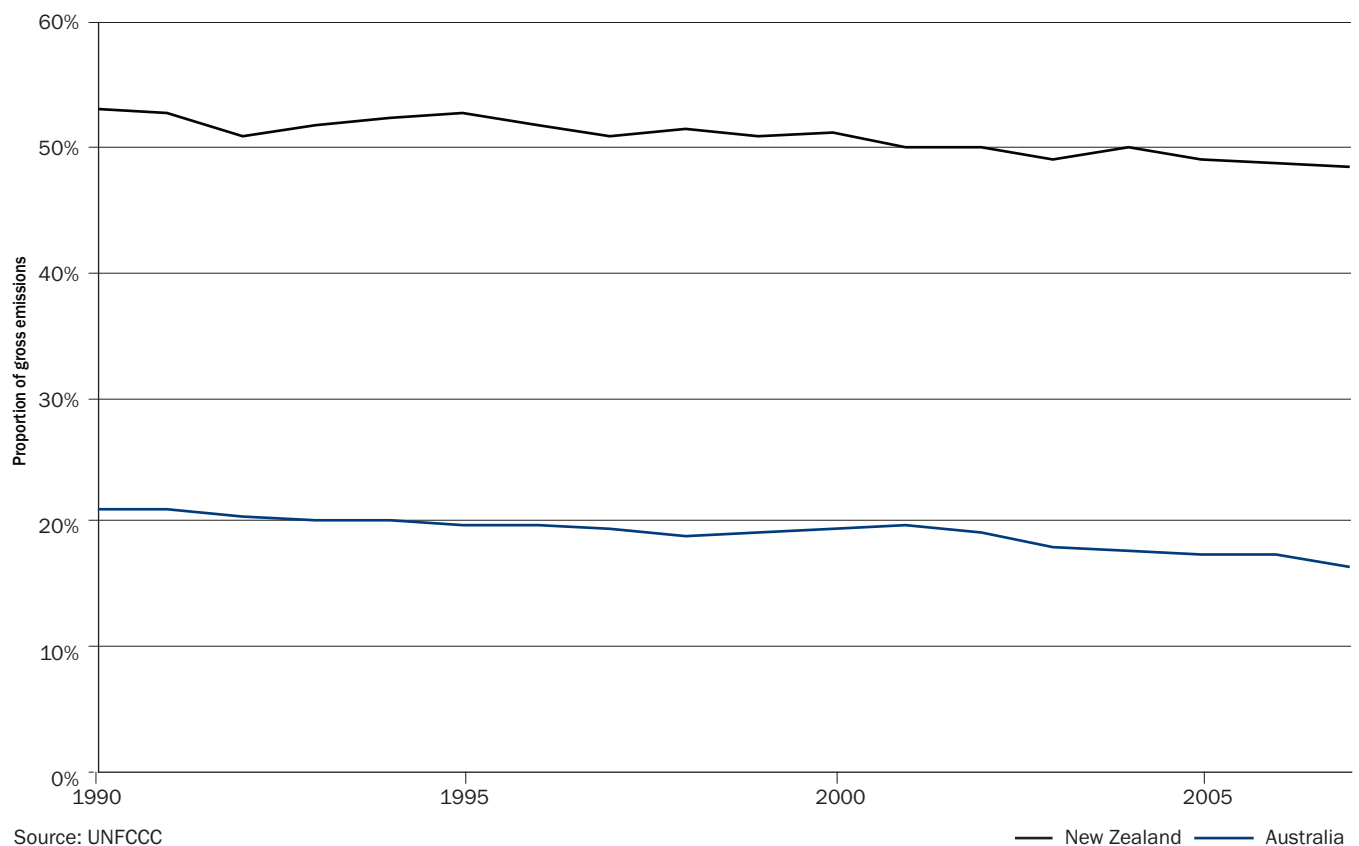
concerned that harmonisation would mean that the benefits of trans-Tasman regulatory competition would be lost.

Levelling the playing field

The second traditional reason advanced for harmonisation is to remove any competitive disadvantages faced by firms in one country selling into another. A common example is additional health standards applying to imported goods that do not apply to domestically-produced goods. Generally, implementing this sort of policy involves the destination country agreeing to apply the same regulatory provisions or taxes to both domestically-produced and imported goods and services.

In the case of emissions trading, the argument is that if country A puts a price on carbon, but country B does not, firms in country A will be at a disadvantage in both exporting their products to country B and in terms of goods imported into country A from country B. By far the largest impact of emissions trading on firms' costs will be the price of emissions; compliance costs, especially for the sorts of large firms with compliance obligations, are likely to be a small proportion of the price of units, especially once initial set-up and learning costs have been met. So what is needed in the trans-Tasman context for there to be a level playing field is that scheme coverage be the same and that covered firms face the same price of emissions.

Figure 2: Agriculture is much more important in New Zealand



The way the Australian and New Zealand schemes are set up, it will be the ‘world price’ of emissions units that will drive the price of units in both schemes, although both Australia and New Zealand are proposing to fix (and in the case of Australia, then cap) the prices of units in the initial transitional stages of their scheme.

Coverage is an area where domestic policy choices will have a greater impact on firms. Unilaterally, Australia and New Zealand have both decided to cover transport (liquid fossil fuels), stationary energy and industrial processes. So firms in these sectors – and firms with inputs from these sectors – will be on a similar footing, given the expectation of a common price of emissions in both countries. Agriculture will be the one sector where, under current proposals, there will be an enduring difference in treatment if Australia does not decide to apply its emissions trading scheme to this sector.

With the Parliaments divided along political party lines about scheme design, introducing the possibility of harmonisation is only likely to complicate the domestic political situations. This political difficulty is likely to be greater in New Zealand, ...

In answering a question in Parliament on whether New Zealand was considering excluding agriculture from its emissions trading scheme, the Minister for Climate Change Issues, Nick Smith, recently said:

Countries are free to implement their own domestic policies to reduce emissions, and most countries for which agriculture contributes a small proportion of their emissions have not included it. That means other sectors of the economy must carry the cost. The problem for New Zealand is that agriculture contributes such a large portion of our emissions that excluding it from our domestic policy puts a higher burden on the rest of the economy.⁹

This problem is illustrated in Figure 2, which shows the proportion of agricultural emissions in each country’s total since 1990.

Thus, despite any competitiveness concerns, it seems highly likely, not to mention being highly desirable on environmental and equity grounds, that agriculture will have to be included in the New Zealand emissions trading scheme. This is a good example of where international considerations, while important, are not the only factor in scheme design.

Harmonisation of trans-Tasman emissions trading schemes will have no impact on the competition that Australasian firms face from the rest of the world. It is possible

that in time all countries will agree to take action to mitigate emissions, meaning that there is either a price or regulatory constraints on emissions in all countries. But that day is some way in the future. In sum, the case for harmonisation to create a true level playing field looks weak, given the different industrial structures of our two countries and the existence of the rest of the world.

Leakage

The idea that the uneven application of emissions trading schemes between countries can cause shifts in the location of production features prominently in the literature of scheme design. It is a variant of the level playing field argument, but looks at the effects of uneven scheme application on the location of investment. The idea runs like this: if country A puts a price on carbon, but country B does not, firms in country

A will have an incentive to shift production to country B. If this happens, country A will have lost employment and GDP and firms will incur relocation costs, but there will be no impact on climate change, since global emissions will stay the same and, as noted above, the location of emissions does not affect their impact on climate change. Even if firms do not relocate plant, because to do so would involve scrapping otherwise economic assets, the argument is that firms will not seek to increase investment in a country with stringent emissions regulations.

The empirical evidence to support the idea that leakage is a real problem is weak.¹⁰ Indeed, it is often pointed out that the European Union, despite having stringent general environment regulations, is the location of significant industrial production, suggesting that firm location is driven by other considerations.

It is hard to see that leakage, if it is a problem, is one that can be addressed by trans-Tasman harmonisation. Even if Australia and New Zealand agreed to have identical and stringent emissions trading schemes, thus removing it from firm decisions about location across the Tasman, the rest of the world is still available as a investment location. It is hard to see why a New Zealand firm that was able to relocate production to Australia couldn’t equally relocate to a developing country: mobile capital is, after all, mobile.

The institutional case

I think the economic case for harmonisation is weak, although I acknowledge that that conclusion is based on a number of judgements. But even if a strong economic case for harmonisation could be made, there are significant constraints that make successful harmonisation unlikely in the short term.

In addition to advocating for clarity of objectives when considering trans-Tasman regulatory cooperation, the Australia and New Zealand School of Government also suggests that key judgements need to be made about

the following policy objectives when considering the appropriateness of trans-Tasman cooperation: certainty, influence, flexibility and feasibility. The relative weight and compatibility of these objectives differs in different contexts. In the context of harmonising emissions trading schemes in New Zealand and Australia, the central difficulty is that not all the objectives are compatible or reconcilable.

For instance, a high degree of certainty about each party's commitments and the processes for achieving them will be needed if the two schemes are fully harmonised or linked. As noted above, a treaty or political cooperation agreement would almost certainly be required to specify the commitments and support required to achieve these levels of harmonisation. At the same time, emissions trading schemes are new regulatory instruments in both countries. Because neither scheme is yet fully operational, their likely impacts are not known for certain, although they are expected to have broad-based impacts across the economy. Accordingly, both governments will want to retain significant influence over decision making to ensure flexibility to respond and to adapt the schemes to meet local conditions. But giving both governments influence and maximising flexibility is not consistent with the high degree of certainty that is required to fully harmonise or link the two schemes. It necessarily introduces uncertainty because of the ability of either government to change the rules of the game at a later date.

This ultimately casts a shadow over the feasibility of fully harmonising or linking the two schemes. If it is not possible to provide the degree of certainty required to achieve harmonisation while meeting both governments' needs for influence and flexibility, then embarking on the process of negotiating and signing a treaty or political cooperation agreement may be a futile exercise from the outset. Negotiations could easily become bogged down as the parties seek to reconcile inconsistent and incompatible objectives.

On the other hand, a lower level of coordination – such as independent but mutual alignment of scheme design – may provide the parties with maximum influence and flexibility, but would lack any real certainty about the outcomes going forward. If the goal of harmonisation is to align the schemes to deliver purported economic benefits, then an arrangement whereby scheme design could diverge at any time due to the two governments' ability to make unilateral changes seems to defeat the purpose of the exercise.

The question of feasibility is also important in the context of the political situations in both countries. With the Parliaments divided along political party lines about scheme design, introducing the possibility of harmonisation is only likely to complicate the domestic political situations. This political difficulty is likely to be greater in New Zealand, since New Zealand is more likely to change its scheme design to accommodate the CPRS design than the reverse. Any amendment will involve cost to someone – whether falling on the taxpayer/consumer or polluters – and will therefore provide an opening for opposition to the change. This may

be in the form of opposition from a political party, from affected interest groups, or general public opposition to the prospect of Australian influence over regulatory design in New Zealand.¹¹ It has already been noted how hard it has been to introduce any form of greenhouse gas regulation in New Zealand. The prospect of harmonisation is only likely to add to the issues that generate opposition, and make the implementation effective regulation harder.

An analysis of the key policy objectives involved when considering harmonisation – certainty, influence, flexibility and feasibility – suggests that even if an economic case for harmonisation could be made, the incompatibility of these objectives in the emissions trading context means that efforts to specify and achieve harmonisation are unlikely to be successful. Furthermore, the issues that any harmonisation efforts may give rise to are only likely to further complicate the already volatile political situations in both countries, which could ultimately threaten each government's chances of introducing effective domestic regulation.

Conclusion

It might seem self-evident that Australia and New Zealand should jointly design and operate their emissions trading schemes, but the analysis presented in this article suggests otherwise. And that is the point: there should be careful analysis of the issue, not a jump to an automatic conclusion.

At the macro level, New Zealand and Australia have independently designed very similar schemes, based on similar policy objectives. The proposed changes recently announced by the New Zealand government move the two schemes even closer together. Both countries are proposing to take costly action to reduce emissions as part of wider global efforts to limit the effects of climate change. Both know that their efforts in isolation will have minimal effect, but they also know that joining with other developed countries to take early action is required to build the truly global cooperation needed.

But the industrial structures of the two countries are quite different, leading to very different emissions profiles. This means that the detailed focus of the two emissions trading schemes need to be different. In New Zealand, the focus needs to be on agriculture, forestry and transport, as these are the three largest sources of emissions. In Australia, stationary energy dominates.

Emissions trading is a relatively new policy instrument. While there are examples of small-scale tradable property rights schemes operating on both sides of the Tasman (commercial fisheries in New Zealand, abalone in Tasmania), neither country has any experience in designing or operating a national-scale scheme with the wide coverage proposed. There is, therefore, a case for policy advisers and decision makers learning from each other as we proceed. There is also increasing international experience on which to draw: the EU has operated a large-scale emissions trading scheme since 2005; the United States has used such a scheme to good effect in combating issues like acid rain. But it is a long step from learning from experience to harmonisation.

Given the complexity of harmonisation and the costs – in terms of both policy resources and future flexibility and sovereignty – I am not convinced that the case for harmonisation has been made, especially in the short term. I believe that while actively learning from each other's experience, New Zealand and Australia should focus their attention on the unilateral implementation of their respective emissions trading schemes and the international climate change negotiations. In time there may be advantages in drawing the schemes closer together, but not now.

In the context of wider trans-Tasman policy development, I think that there are valuable lessons to be taken from considering the costs and benefits of harmonisation of emissions trading. Just because each country has decided to implement the same policy tool does not ipso facto mean that a single, harmonised scheme is required. Policy makers should continue to subject such proposals to detailed scrutiny to ensure that the rhetoric of cooperation does not automatically mask the reality of the good case for separate policy design.

- 1 This paper is based on a presentation that I gave, together with Alastair Cameron of Buddle Findlay, on 31 July 2009 at a seminar entitled *Emissions Trading – Harmonisation with Australia: Issues and Options*. The seminar was organised by the Institute of Policy Studies and the New Zealand Climate Change Research Institute. I would like to thank Alastair for permission to use some of his material in this article. Comments by participants at the seminar and by Jonathan Boston are also gratefully acknowledged. I, of course, remain responsible for all the views in this paper.
- 2 Data download from the World Resource Institute's climate analysis indicators tool: <http://cait.wri.org/>.
- 3 Bali Action Plan, FCCC/CP/2007/6/Add.1.
- 4 See section 3 of the New Zealand Climate Change Response Act 2002 and clause 3 of the Australian Carbon Pollution Reduction Scheme Bill.
- 5 Everything to do with Kyoto is complicated and has an acronym. Technically, removals are from 'Land Use, Land Use Change and Forestry', or LULUCF.

- 6 For an outline of the different kinds of institutional and operational support already used by the governments of New Zealand and Australia see Department of Finance and Administration and Ministry of Economic Development (2007), pp.11-17.
- 7 'Agreement between the governments of Australia and New Zealand concerning a joint food standards system', at <http://www.mfat.govt.nz/Foreign-Relations/Australia/1-CER/0-Reference/0-joint-food-standards.php>.
- 8 For example, under Kyoto rules, all emissions from deforestation are deemed to take place in the country where the trees grew and at the time the trees fell; emissions from fossil fuels are deemed to take place in the country where the fuels are consumed not mined, while emissions from industrial processes are deemed to take place where the goods are produced, not consumed; and emissions from international transport and travel are excluded.
- 9 Hansard, first session, 2008-09, week 21, vol. 656, p.5753.
- 10 The Stern Review noted that 'The empirical evidence on trade and location decisions, however, suggests that only a small number of the worst affected sectors have internationally mobile plant and processes' (p.253).
- 11 In spite of the many examples of trans-Tasman regulatory coordination, there are many examples of New Zealanders' vehement opposition to Australian influence over their domestic decision making. The recent controversy about the mandatory fortification of bread with folic acid is a recent reminder, where public opposition to a joint New Zealand/Australia standard requiring mandatory fortification lead to the New Zealand government abandoning the standard in spite of its agreement with Australia to introduce joint food standards. Similar public opposition to joint New Zealand/Australia regulation derailed the proposal for a joint medicines and therapeutics regime. A key component of the opposition was the belief that New Zealand was ceding its sovereignty over decision making to the Australians.

References

- Department of Finance and Administration and Ministry of Economic Development (2007) *Arrangements for Facilitating Trans-Tasman Government Institutional Co-operation*, Melbourne: Australia and New Zealand School of Government
- Garnaut, R. (2008) *The Garnaut Climate Change Review, Final Report*, Melbourne: Cambridge University Press
- Stern, R. (2007) *The Economics of Climate Change: the Stern Review*, Cambridge, UK; New York: Cambridge University Press
- Quigley, N. (2003) *The Economics of Harmonisation: implications for reform of commercial law and regulation in New Zealand*, Wellington: New Zealand Institute for the Study of Competition and Regulation

CLIMATE CHANGE 101: An Educational Resource

by Andy Reisinger (co-author: Lenny Bernstein)

Climate change is widely recognised as the most important issue now facing humanity. Proposals to reduce emissions or to adapt proactively to future climate changes often result in intense public debate about the urgency, feasibility, and cost, as well as the appropriate balance, of responses to climate change. A better and much broader understanding of the causes and effects of climate change, together with the options for mitigation and adaptation at the global scale, is critical for such societal discussions to be fruitful. *Climate Change 101 – An Educational Resource* provides a clear, succinct, and measured summary of our current knowledge of climate change, its potential impacts, and the scope for reducing greenhouse gas emissions and adapting to inevitable changes.

Climate Change 101 draws its substance mostly from the findings contained in

the Fourth Assessment Report of the Intergovernmental Panel on Climate Change. But it also highlights more recent scientific developments and illuminates the key issues that underpin the current international negotiations for a new global agreement on climate change. This book is intended as an educational resource for anyone seeking a robust scientific overview of the complex and interdisciplinary challenge that climate change represents for the global community.



An Institute of Policy Studies publication by Andy Reisinger (co-author: Lenny Bernstein)
 Publication November 2009
 Format A4 Paperback, pp 303
 ISBN 978-1-877347-34-4 Price - \$45 (including P&P within New Zealand)
 Place your order by email, phone, fax or mail to
 Institute of Policy Studies, Victoria University of Wellington
 Email ips@vuw.ac.nz Telephone +64 4 463 5307 Fax +64 4 463 7413
 PO Box 600, Wellington, New Zealand
 An invoice will be issued with your order

Institute
of
policy
studies