

CONVENOR, MINISTERIAL GROUP ON CLIMATE CHANGE

The Chair
CABINET POLICY COMMITTEE

CLIMATE CHANGE: NEXT STEPS FOR RATIFICATION OF THE KYOTO PROTOCOL

PROPOSAL

1 The success of the Kyoto Protocol negotiations in Bonn raises the question of next steps for New Zealand. It is expected that the Protocol will be technically ratifiable by December 2001 after COP7. Work can now commence on policy consultation and legislation in order to meet the Government's intention to ratify by the time of the World Conference on Sustainable Development in September 2002. This paper sets out the issues and implications associated with the process of ratification, remaining risks and the proposed timetable for consultation and development of the necessary legislation and policy. It seeks agreement to the process by which decisions will be taken on ratification and the necessary legislation and domestic policy mix to meet New Zealand's obligations under the Protocol.

EXECUTIVE SUMMARY

2 Barring major changes, the Kyoto Protocol is expected to be technically ratifiable by December 2001 following adoption of the legal texts and resolution of remaining risks at COP7 in November 2001.

3 The paper proposes that a staged approach be agreed, with consultation on the National Interest Analysis¹ (NIA) and introduction of minimal legislation for ratification (Act I) occurring broadly in parallel with further consultation on development of the domestic policy mix. Any legislation required to implement the domestic policy mix (Act II) could be introduced at around the time of ratification in August 2002.

4 A staged approach in accordance with the timeline set out in Annex 2 provides the maximum opportunity for consultation on the issue of whether to ratify the Protocol and the preferred policy mix, within the constraints imposed by the Government's intention to ratify the Protocol by September 2002.

5 The paper notes that a formal decision in early 2002 on whether to ratify the Protocol should take into account the outcomes of the ratification consultation, the final NIA and economic implications of ratification, including competitiveness effects and the Government's preferred domestic policy mix. Officials have received preliminary results of modelling on the economic implications of meeting our obligations under the Protocol. A briefing note on such work has been prepared for Ministers' consideration alongside this paper.

¹ Standing Orders require the presentation of a National Interest Analysis to Parliament prior to ratification and, typically, the introduction of any legislation necessary to give effect to the obligations being entered into. The National Interest Analysis reports on the obligations being entered into and the social, economic, environmental and cultural implications of ratification.

6 As next steps, the paper directs officials to report to Cabinet Policy Committee by 5 October 2001 on: the minimal legislation required for ratification; a consultation document, including a draft national interest analysis; and the policy development and consultation on the objectives and options for a comprehensive mix of domestic policy measures.

BACKGROUND

7 The Government has publicly stated that it intends to ratify the Kyoto Protocol by the World Summit on Sustainable Development (also called Rio+10) to be held in Johannesburg in September 2002 provided the Protocol is ratifiable. In July, countries meeting in Bonn at the resumed sixth session of the Conference of the Parties (also referred to as COP6.5) reached political agreement on the key elements of the rules by which the Protocol will function. The final legal text of the Protocol is still to be completed and adopted in Marrakech at COP7 in early November 2001.

8 Under the Protocol, the primary legal obligation is that the Government must demonstrate that emissions of greenhouse gases during 2008 – 2012 do not exceed New Zealand's assigned amount of emissions units. Under the Protocol, New Zealand has an initial assigned amount of emissions units stemming from our target.² This initial assigned amount will be increased to take into account credits earned by New Zealand's forest sinks. It will also be adjusted to account for international trading in emissions units.³ Stated another way, New Zealand will be required to take responsibility for its greenhouse gas emissions in excess of 1990 levels between 2008 and 2012. Assuming that business-as-usual emissions will exceed our assigned amount, the Government would need either to purchase emission units or to introduce policy measures to reduce emissions to meet the target.

9 Additional legal obligations in the Protocol include monitoring and reporting greenhouse gas emission inventories and maintaining a national registry to account for changes of assigned amount as a result of additions and subtractions to assigned amount relating to forest sinks and international trading.

OUTCOMES FROM COP6.5

10 Of critical importance to New Zealand in the negotiations at COP6.5 in Bonn were the rules for the mechanisms that countries can use to manage emissions and assigned amount. Key mechanisms include "flexibility mechanisms" such as emissions trading and emission reduction projects between countries, and forest sinks (credit for forests established after 1990). Securing rules allowing for environmental integrity and substantively unrestricted operation of the mechanisms and sinks provisions is important to significantly lower the costs of meeting our commitments.

11 New Zealand's objectives in the negotiations [POL (00) M 31/5 refers] were essentially met in the political agreement from Bonn. However, the final legal texts of the rules will not be agreed until COP7 in early November 2001. Some risks remain in translating the political agreement into legal texts at COP7, including: whether agreement can be reached on the process for establishing a compliance regime with binding consequences; clarifying the transferability of units under the flexibility mechanisms; and

² New Zealand's initial assigned amount for the five-year commitment period 2008-12 is equal to five times the 1990 level of emissions.

³ Information collection and recording systems are also required to verify and account for New Zealand's assigned amount of emissions units compared with actual emissions.

clarifying a reserve requirement to retain a minimum quantity of units of assigned amount in the national registry. Annex 1 highlights the key outcomes from COP6.5 and the remaining risks. It is important the legal texts are agreed and remaining risks resolved before a formal decision on whether to ratify the Protocol is taken.

OTHER KEY ISSUES FOR RATIFICATION

12 Barring major changes at COP7 and the adoption of the legal texts, it is expected that the Protocol will be ratifiable by December 2001. Key issues associated with a future decision on ratification include the:

- **policy means** by which the Government will meet its legal obligations under the Protocol;
- **economic implications** for New Zealand of meeting the commitments under the Protocol, including costs and benefits of policy measures, international competitiveness effects and economic development opportunities;
- **environmental credibility** and long term prospects for the Protocol as a basis for global efforts, including drawing in the US over time and extending commitments to major developing countries beyond 2012.

Comment

13 There is now a reasonable level of certainty that enough countries will ratify to reach the threshold of support required for the Protocol to enter into force⁴. Although the US is likely to remain outside the Protocol (at least in the near term and possibly the first commitment period), there is now a high expectation that Japan will ratify and an increased likelihood that Canada and also Australia will consider ratification. The Protocol will be less effective without the US, but possibly to our advantage if the international price of units of assigned amount is lower (although the value of our sink credits will also be lower). Given the commitment at Bonn by all countries except the US, it is now very likely that the Protocol and its mechanisms will be the vehicle for future action on global warming.

14 Projections indicate that if New Zealand continues on its current track greenhouse gas emissions will be 14 to 19% above 1990 levels during 2008 to 2012. This equates to excess emissions of 50 to 70⁵ million tonnes of carbon dioxide equivalent over these five years. Credits from forest sinks are expected to be in the order of 110 million tonnes, although the Government has previously noted that making sink credits internationally tradable would reduce the risk of them being used to shield other emitters from facing the costs of their emission responsibilities [CAB (00) M 25/4C refers].

15 A mix of existing and additional policy measures and economic incentives will therefore need to be implemented to meet our commitments during 2008 to 2012. The options for policy measures will be the subject of a separate paper. Achieving our commitments will require decisions on the coverage of emitting sectors, the degree of responsibility sectors bear for their emissions and the comparability of the responsibilities and incentives across sectors.

⁴ The Kyoto Protocol will enter into force when at least 55 countries ratify it, including developed countries that account for more than 55% of total carbon dioxide emissions from developed countries in 1990.

⁵ The range is primarily a result of uncertainties in projections for agriculture sector emissions.

Economic implications

16 Officials have commissioned the Australian Bureau of Agricultural and Resource Economics (ABARE) to do modelling work on the impact of the Protocol. Preliminary results have been received, and officials have prepared a briefing paper for Ministers for consideration alongside this paper. The paper covers these initial ABARE results, other modelling results available and further analysis to be done. Work will continue on the economic implications, including sectoral effects, of different policy options as part of the policy development programme and preparation of the formal National Interest Analysis (NIA). Officials will work closely with the different sectors on this issue, including careful review of any independent economic analyses⁶. The Government will also need to consider and factor into their assessments the potential benefits from the economic development opportunities that climate change presents. Officials will be providing advice on this in due course.

REQUIREMENTS FOR RATIFICATION OF THE PROTOCOL

17 Before ratifying the Protocol, the Government will need to present to Parliament a National Interest Analysis (NIA) and enact legislation that shows that it has the ability to meet its legal obligations under the Protocol. As part of the process for preparing the NIA the Government should consult on two basic points: whether to ratify; and the means proposed to implement the obligations under the Protocol.

18 There are two broad options for decisions on the policy framework and associated legislation required for ratification:

- **comprehensive approach** where the mix of policy measures and incentives for managing emissions is agreed on and included into legislation (a single Act) for enactment prior to ratification; and
- **staged approach** where minimal legislation is introduced and enacted first (Act I) to allow ratification to occur, while the mix of policy measures and incentives for managing emissions continues to be developed and consulted on for subsequent legislation (Act II).

19 It is well-established constitutional practice that New Zealand ratifies a treaty after it has in place the legislative and other measures which are necessary to enable full compliance with the Treaty once it enters into force for New Zealand.

20 The ideal legislative option from a constitutional and public policy perspective is a comprehensive approach. However, adopting such an approach in order to meet the Government's intention to ratify the Protocol by the time of the World Summit on Sustainable Development in September 2002 would create serious risks, given the delays internationally and relatively low level of engagement with some sectors and the public. In particular, the time available for the necessary rounds of consultation on a comprehensive approach and development of the legislation is unlikely to be viewed as adequate by stakeholders and Ministers may not be in a position to take substantive decisions on the policy mix.

⁶ Officials are aware of two studies being undertaken by NZIER, one for an industry client on the economy wide impacts of policy options and the other on the impacts for the forestry sector as part of the joint private/government wood processing strategy work.

21 Work done by officials suggests that a staged approach that would enable adequate consultation to occur on the question of ratification and on the domestic policy response is possible. With the staged approach there is still a significant risk with seeking to ratify (stage I) in advance of the policy mix and its impacts being fully known (stage II). These matters will require close and careful management.

PROPOSED TIMETABLE FOR A STAGED PARALLEL APPROACH TO RATIFICATION AND DOMESTIC POLICY RESPONSE LEGISLATION

22 A timetable for a staged approach that will enable the minimal legislation required for ratification to be enacted in time for the World Summit on Sustainable Development in early September 2002 is set out in Annex 2. The stages would proceed in parallel with the policy mix being presented in two steps to stakeholders and a preferred policy mix being approved by Cabinet and ideally introduced into legislation by the time ratification legislation is enacted.

23 The **ratification legislation** (Act I) would involve:

- consultation from mid October to mid December 2001 on the obligations under Protocol, how the Government can meet its commitments (initially based on the introduction of minimal legislation that allows the Government to buy and sell units on the international market and collect information on emissions and assigned amount, but with a comprehensive domestic policy response under development) and views on whether to ratify or not. This consultation would be informed by the draft national interest analysis based on scenarios of the macro-level impacts of the Protocol; and
- introduction of the NIA and minimal ratification legislation by mid March 2002 for enactment by August 2002.

24 Note that a formal decision on whether to ratify the Protocol would not need to be made until after the outcomes of the ratification consultation and the Government had considered and approved the NIA and ratification legislation.

25 The parallel **domestic policy development** pathway (Act II) would involve:

- initial consultation on policy objectives, existing/proposed measures in the areas of energy efficiency, transport and waste and research in agriculture, and the options for comprehensive market-based economic incentive policy measures;
- decisions on the preferred mix of market-based economic incentive policies for the management of emissions and assigned amount (including sinks), based on the initial consultation on the options;
- a second round of consultation on the preferred mix of market-based economic incentive policies and the legislation required for their implementation, if any;
- announcing the overall domestic policy package in early July 2002, prior to passing the ratification legislation; and
- legislation on the domestic policy mix could be introduced into the House by August 2002, but not passed until mid-2003.

CONSULTATION

26 The following departments have been consulted and support the recommendations in this paper: the Ministries of Environment, Economic Development, Research, Science and Technology, Agriculture and Forestry, Transport, Foreign Affairs and Trade and the Treasury. The Department of the Prime Minister and Cabinet and Te Puni Kokiri were also consulted in the preparation of this paper.

27 While New Zealand business has specific concerns about the Kyoto Protocol and how associated policy is likely to impact on them, they are also concerned about moving too far and fast with legislation given uncertainty about the actions of our key trading partners. Concerns about competitiveness effects are accentuated by the prospect of major players like the US staying outside of the agreement. Federated Farmers' rejection of ratification without our major trading partners is a case in point and is echoed by others. Some industries are also commissioning their own economic research. There is a strong need to have a carefully phased and inclusive approach to consultation on ratification and on the domestic policy mix.

FISCAL IMPLICATIONS

28 Work on undertaking a process for ratification can be met within existing baselines. At COP6.5 developed countries including New Zealand issued a political statement of commitment to funding for Protocol activities. New Zealand's share of this commitment is estimated to be in the order of US\$2.5 million per annum by 2005. Officials will examine possible sources for this funding and to what extent, and by when, New Zealand is able to contribute new and additional funding. This issue can be considered in the 2002 Budget.

29 The minimal approach to ratification legislation is technically based on New Zealand being able to meet its commitments through the Government buying and selling units on the international market. There would be substantial fiscal implications if this approach were actually relied on to meet our commitments during 2008 to 2012. Officials will report further on this as part of the proposed report-back on the ratification legislation.

LEGISLATIVE IMPLICATIONS

30 Ratification will require legislation. A separate submission will be made seeking policy decisions and approval for drafting instructions for PCO. A bid has been accepted into the legislative agenda for 2002 for a Climate Protection Bill. In essence the Bill would be split into two parts.

RECOMMENDATIONS

31 It is recommended that the Committee:

1. **note** that, barring major changes, the Kyoto Protocol is expected to be technically ratifiable by December 2001 following adoption of the legal texts at COP7, however, some risks remain in confirming the political agreement reached at COP6.5, in particular agreement on a process to develop a binding compliance regime and clarification of some technical aspects of the flexibility mechanisms;
2. **note** that New Zealand was amongst the majority of developed countries, including the European Union, Canada, Switzerland, Norway and Japan, that made a political statement of commitment to funding for Protocol activities in support of developing

countries and that New Zealand's share of this commitment is in the order of US\$2.5 million per annum by 2005;

3. **note** the preparation by officials of a briefing note, available with this paper, on the preliminary results of modelling commissioned by officials on the economic impacts of the Protocol;
4. **note** that there are two options for how to proceed with consultation, decisions on the policy mix and the introduction of legislation to ratify the Protocol:
 - 4.1. a comprehensive approach whereby consultation occurs on the policy and then a national interest analysis and any required legislation is introduced prior to ratification;
 - 4.2. a staged approach whereby the consultation and the development and introduction of the National Interest Analysis and legislation for ratification (Act I) occurs broadly in parallel with further consultation on development of the policy mix and that any legislation required to implement the policy mix (Act II) could be introduced at around the time of ratification;
5. **agree** to adopting a staged approach in accordance with the timeline set out in Annex 2 to provide sufficient opportunity for consultation on the issue of whether to ratify the Protocol and the preferred policy mix;
6. **agree** that officials should begin preparation of a legislative approach to allow New Zealand to ratify the Protocol by the time of the World Summit on Sustainable Development in Johannesburg in early September 2002;
7. **note** that a formal decision on whether to ratify the Protocol in early 2002 should take into account the following considerations:
 - 7.1. outcomes of consultation;
 - 7.2. policy means by which the Government intends to meet its commitments;
 - 7.3. final National Interest Analysis and the economic implications of ratification, including costs and benefits of policy measures, international competitiveness effects and economic development opportunities;
 - 7.4. environmental credibility of the Protocol as the basis for long term action;
8. **direct** officials to report to Cabinet Policy Committee by 5 October on:
 - 8.1. the legislation required for ratification (Act I in recommendation 4.2 above) and fiscal implications of ratification;
 - 8.2. the approach for policy development and consultation, including the initial consultation on policy objectives, existing/proposed measures in the areas of energy efficiency, transport and waste and research in agriculture, and the options for comprehensive market-based economic incentive policy measures; and

- 8.3. the consultation document(s) , including the draft National Interest Analysis, to support the consultation on the ratification legislation and the initial consultation on the policy objectives and options.

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ANNEX 1: KEY OUTCOMES FROM COP6.5 AND REMAINING RISKS

1 Contrary to expectations, COP6.5 in July 2001 produced a comprehensive political agreement on the rules necessary for implementation of the Kyoto Protocol. The outcomes on the key ratification issues are:

- **flexibility mechanisms** (international emission trading, joint implementation, clean development mechanism)⁷ – the rules provide for a commitment period reserve requirement to retain at least 90% of initial assigned amount (or five times the most recent emission inventory) in the national registry, but do not otherwise limit trading under the mechanisms. There is no specific requirement for a proportion of effort in meeting the target to come from domestic actions (so-called “**supplementarity**”). Participation in the mechanisms will also require acceptance of the agreement on compliance, in addition to meeting monitoring and reporting requirements;
- **compliance** – there was agreement on a process to develop binding consequences for non-compliance with emission targets, but without prejudging the legal format (i.e. an amendment to the Protocol or a separate legal agreement);
- **sinks** – full recognition for a limited set of forest activities since 1990 (afforestation, reforestation and deforestation) which potentially provides a credit for New Zealand of around 110 Mt CO₂ during the commitment period and includes a fix to account for harvesting of fast growing forests (which applies mainly to Australia and New Zealand). Of lesser importance to New Zealand is the limited recognition given to additional forest sink activities. Sinks in the clean development mechanism are limited to afforestation and reforestation;
- **nuclear** - despite considerable opposition, the conference gave the clearest possible message that nuclear power generation should not be eligible for inclusion in either the CDM or JI projects; and
- **finance and support** – in response to developing country concerns about levels of financial support for their needs under the Protocol (and in the absence of any US support) the EU and a number of other developed countries including New Zealand issued a political statement of commitment to funding for Protocol activities. New Zealand's share of this commitment is estimated to be in the order of US\$2.5 million per annum by 2005.

2 The final legal texts in each of the key areas of the rules will not be agreed until COP7. COP7 will be held in Marrakech from 29 October to 9 November 2001. New Zealand must continue to play an active role in the negotiations to ensure that key remaining risks are resolved in our favour, including:

- **compliance** - the process for elaboration of binding and non-binding consequences and the form of a future legal agreement will likely continue to be the most intensely debated area of the rules. It is in New Zealand's interests to have a strong compliance regime to ensure others will honour their commitments;
- **mechanisms** – resolving the transferability of the units under all three mechanisms (although the debate largely is driven by developing countries and units under the clean development mechanism) and clarifying the operation of the reserve requirement in a way that does not restrict our ability to use the mechanisms and derive value for sink credits.

⁷ International emission trading is the transfer and acquisition of units of assigned amount. Joint implementation and the clean development mechanism refer to trading in credits earned for emission reduction projects and sink enhancements in developed and developing countries respectively.

ANNEX 2: TIMELINE FOR STAGES I AND II

Ratification/legislation (stage I)	Time allowed	Deadline
Cabinet papers on: the ratification legislation, including authority to prepare drafting instructions and consultation document including draft National Interest Assessment (NIA)	2 months	15 Aug – 12 Oct 2001
Consultation on ratification	2 months	15 Oct – 15 Dec 2001
Officials prepare drafting instructions	1 month	15 Oct - 15 Nov 2001
PCO drafting of ratification legislation	3 months	15 Nov - 15 Feb 2001
Submissions analysis, completion of NIA and development of Cab paper	1.5 months	15 Dec 2001 – 15 Feb 2002
Cabinet approval of draft legislation for introduction/approval of NIA and decision on whether to ratify,	1 month	15 Feb – 15 Mar 2002
Introduction of NIA and consideration by Select Committee	2 months	15 March - 15 May
Caucus/ introduction of legislation into house/1 st reading and refer to Select Committee	-	By 15 May 2002 (15 sitting days after intro of NIA or report back from select committee)
Select Committee - (submissions, hearings, deliberation report back)	2.5 months (+)	By 15 May – 1 Aug 2002
Second reading	1 week	8 Aug 2002
Committee of the whole/Third reading	1 week	14 Aug 2002
Enact	-	Late Aug 2002
Prepare and transmit instrument of ratification to depository	1 week	Late Aug 2002
Ratify (World Summit on Sustainable Development)	-	2 Sep – 11 Sep 2002

Domestic policy package development (stage II)	Time allowed	Deadline
Cabinet papers on policy options	2 months	15 Aug – 15 Oct 2001
Consultation on policy options	2 months	15 Oct - 15 Dec 2001
Submissions analysis and development of cab paper on preferred policy package	1.5 months	15 Dec – 15 Feb 2002
Cabinet approval of preferred policy package and preparation of drafting instructions	1 month	15 Feb – 15 Mar 2002
Consultation on preferred policy approach	2 months	15 Mar – 15 May 2002
Submissions analysis and development of cab paper	1 months	15 May – 15 June 2002
Cabinet approval of policy package	1 month	15 June – 15 July 2002
Introduction of framework legislation to implement policy package	1.5 months	15 July – 30 August