ANALYSIS OF THE POLICY AND REGULATORY FRAMEWORK OF THE NEW ZEALAND EMISSIONS TRADING SCHEME: THE CLOSER ECONOMIC RELATIONS TREATY

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The New Zealand Government has recently announced its intention to implement a New Zealand Emissions Trading Scheme with the purpose of reducing New Zealand's greenhouse gas emissions. This article outlines the policy and regulatory framework of the New Zealand Emissions Trading Scheme, with a particular focus on the implications for Australia and New Zealand bilateral trade and the Australia and New Zealand Closer Economic Relations Treaty.

1. PART ONE: AN ANALYSIS OF NEW ZEALAND'S EMISSIONS TRADING SCHEME: POLICY AND FRAMEWORK

1.1 Introduction

Since the late 1980s, the international community has accepted that climate change is a common concern of humankind that must be addressed through international cooperation. The United Nations Framework Convention on Climate Change was the first definitive international document to accept climate change as directly and indirectly induced by human activity.[1] However, the Kyoto Protocol provides specific measures and commitments that can be taken by member states in order to reduce their greenhouse gas emissions. One such measure is emissions trading. Article 17 of the Kyoto Protocol establishes emissions trading as a supplemental instrument to domestic action to reduce greenhouse gases. Emissions trading has arguably become the most dominant measure for addressing climate change in 2008.

1.2 Background

New Zealand ratified the Kyoto Protocol on 19 December 2002 with the introduction of the *Climate Change Response Act 2002*. The legal obligations from ratification took effect from 16 February 2005. Under the Kyoto Protocol, New Zealand has accepted the obligation to return its net greenhouse gas emissions to 1990 levels by 2008-2012. While this commitment is lower than other countries, New Zealand is currently projected to fail to meet its obligations. According to the New Zealand Treasury, as of 8 August 2007 that commitment was NZ$540 million. Under business-as-usual models, New Zealand's emissions are rising and the cost of the Kyoto Protocol commitment is guaranteed to rise if emissions are not curbed dramatically.

On 20 September 2007, the New Zealand Labour Government Minister of Energy, the Hon David Parker, announced details of the New Zealand Emissions Trading Scheme (the NZ ETS).[2] The Government had been planning such a scheme since December 2006 when the *Draft New Zealand Energy Strategy* noted a preference for emissions trading as a program to reduce carbon

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1 *United Nations Framework Convention on Climate Change*, Art 1(2).

2 http://www.beehive.govt.nz/speech/emissions+trading+scheme+announcement.

emissions.[3] The NZ ETS would mark the first all sector, all greenhouse gas, emissions trading scheme in the Asia Pacific region.

Following on from this policy document, the *Climate Change (Emissions Trading and Renewable Preference) Bill* (the Emissions Trading Bill) was tabled in Parliament on 4 December 2007. The Emissions Trading Bill implements the regulatory framework required to establish the NZ ETS, and it has a dual purpose. Firstly, it amends the *Climate Change Response Act 2002* to introduce a greenhouse gas emissions trading scheme which covers all gases and all sectors, and secondly, it amends the *Electricity Act 1992* to create a preference for renewable electricity generation by placing a 10 year ban on all new base-load fossil-fuelled thermal electricity generation (subject to the Minister of Energy's discretion to grant an exemption where such generation is required for security of supply).

1.3 The Future of New Zealand's "clean green" Image

New Zealand has typically been viewed as a "clean" and "green" country. However, with carbon emissions rising, this reputation is beginning to be questioned. Although New Zealand's total greenhouse gas emissions are only between 0.2 and 0.3% of global emission (small from a global perspective), it has the 12th highest per-capita emissions in the developed world.[4] This is due to heavy reliance on private transport and emissions intensive primary export industries.[5]

Nearly 49% of New Zealand's greenhouse gas emissions result from agriculture, where "agriculture" means pastoral and arable farming as well as horticulture.[6] This figure excludes agricultural energy use.[7] This contrasts with an average of 12 per cent in other developed countries.[8] New Zealand also has significant emissions from the deforestation of forests planted before 1990, and emissions from the future harvesting of land afforested since that date are forecast to rise sharply during the decade from 2020 to 2030.

The New Zealand Labour Government has set a "green" vision for the future of New Zealand. This direction has been outlined in key documents such as the *New Zealand Energy Strategy to 2050,* the *New Zealand Energy Efficiency and Conservation Strategy* and the *Framework for a New Zealand Emissions Trading Scheme* (2007). This vision includes such measures as the introduction of:

- a Biofuels Obligation for fuel;[9]
- energy efficient, hybrid and electric vehicles;[10]
- 90% of electricity generation to be from renewable energy by 2025; and [11]
- a New Zealand Emissions Trading Scheme[12]

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3 http://www.med.govt.nz/upload/43136/draft-energy-strategy.pdf (3.2) p 10.

4 *The Framework for a New Zealand Emissions Trading Scheme*, New Zealand Ministry for the Environment and The Treasury, September 2007, p 2.

5 Ibid, p 3.

6 Ibid, p 3.

7 Ibid, p 3.

8 Ibid, p 3.

9 *The New Zealand Energy Strategy to 2050*, New Zealand Ministry of Economic Development, October 2007, cl 4.6.4 (c)

10 Ibid, cl 4.6.4 (d)

11 Ibid, cl 4.6.4 (a)

12 Ibid, cl 9.1.1.

These measures are viewed not only as *critical* for continuing New Zealand's green image but also *necessary* in order to meet New Zealand's international commitments.

1.4 Reducing Emissions at Least Cost

There are two general approaches to reducing carbon emissions; the regulatory approach, and the use of an economic instrument. For a time, the New Zealand Labour Government considered a carbon tax, which was ultimately rejected due to its unpopularity, particularly from the agricultural sector. Further, an emissions tax was seen as a blunt instrument that would require frequent Government intervention to ensure prices were similar to international prices.[13]

The Government has since decided to take the economic instrument approach, with the end product being the implementation of an emissions trading scheme as New Zealand's core price-based measure for reducing greenhouse gas emissions.[14] The overall objective of the NZ ETS has been decided in principle by the Government as follows:[15]

> "That a New Zealand Emissions Trading Scheme will support and encourage global efforts to reduce greenhouse gas emissions by:
> - reducing New Zealand's net emissions below business-as-usual levels; and
> - complying with our international obligations, including our Kyoto Protocol obligations;
>
> while maintaining economic flexibility, equity, and environmental integrity at least cost in the long term."

This objective permeates the scheme and provides a rationale behind decisions regarding the core structure, particularly in relation to the allocation of units, participation of sectors, and international linkage. It also suggests the scheme has been designed to minimise government intervention and administration and to enable participants to take responsibility for reducing and reporting on their own emissions.

Classic emissions trading schemes, such as the United States SO_2 trading system under the framework of the Acid Rain Program of the *Clean Air Act 1990*, operate under a cap-and-trade model where emissions are "capped" at a certain level. Participants in the scheme are required to match all their emissions with a corresponding number of emissions units, administered by a central agency. The number of units available is restricted to the same level as the cap. This ensures that the maximum level of emissions is not exceeded.

The NZ ETS is significantly different from the above model. New Zealand does not need a sub cap for the domestic emissions trading scheme since it will cover all sectors and gases. Thus New Zealand can make use of the international cap set in the Kyoto Protocol.

1.5 Polluter Pays

The NZ ETS is firmly based on the international legal principle of polluter pays. The polluter pays principle states that those who pollute must pay for the consequences of that pollution. Previously, due to the failure of the market to take into consideration the full social and environmental impacts of greenhouse gases, firms could pollute the atmosphere without it being reflected in the price of their product or service.

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[13] *The Framework for a New Zealand Emissions Trading Scheme*, New Zealand Ministry for the Environment and The Treasury, September 2007, p 4.

[14] Ibid, cl 1.1.

[15] Ibid, cl 1.2.

However, under the NZ ETS, firms that emit greenhouse gases or that have carbon-intensive products and services will have to either reduce their carbon emissions or pay for carbon credits. This includes individuals who consume carbon-intensive products; those people will either have to pay the price increase as a result of carbon pricing or switch to low carbon goods and services. As a result of such price increases, it is expected that demand for carbon-intensive products and services will decrease over time.

1.6 All Gases

The government has decided in principle that the NZ ETS will cover emissions from all six greenhouse gases: methane, nitrous oxide, hydro-fluorocarbons, per-fluorocarbons and sulphur hexafluoride, and carbon dioxide.[16] This is already codified in cl 4(1) of the *Climate Change Response Act 2002*, which refers to the list in Sched A of the Kyoto Protocol. This includes carbon dioxide and methane from the agricultural sector. This is particularly significant due to the complexity of reducing agricultural emissions, particularly methane which breaks down at a lower rate than other greenhouse gases.

Gases from the agricultural sector have been particularly controversial given New Zealand's heavy reliance on agricultural exports and the limited opportunities to reduce such gases at present. However, with the late introduction of the agricultural sector into the NZ ETS, it is expected that research will provide future opportunities for agricultural emissions to be reduced.

1.7 All Sectors

In order for the NZ ETS to be fair and equitable, it was concluded that it would need to include all sectors. New Zealand is unique in that almost half of all greenhouse gas emissions in New Zealand are derived from the agricultural sector. This poses some serious issues as the technology for reducing agricultural emissions is still in the experimental stage. While New Zealand has introduced a number of measures to reduce emissions from agriculture, such as the Ministry of Agriculture and Forestry's Sustainable Farming Fund, which provides more than $9 million each year in grants to help farmers adopt environmentally sustainable practices, it would be impossible to expect the agricultural sector to be carbon neutral.

1.8 NZ ETS Participants

The Government has stated a preference for limiting the number of participants involved in the NZ ETS.[17] The objective is to keep compliance and administration costs low while encouraging behavioural changes. By placing the point of obligation, "or the obligation to monitor and report emissions and obtain and retire emissions units to match their emissions",[18] on producers, the cost of emissions is passed through the market to the consumer. It would be both impractical and inefficient for the point of obligation to be placed on individual emitters as compliance costs and administration would make the scheme unviable.

There are different points of obligation depending on the sector:

(a) Liquid Fossil Fuels[19]

In the liquid fossil fuels sector, the point of obligation will be at the point of fuel supply, production or import. This primarily relates to the transport sector and would include the

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[16] Ibid, cl 4.2.
[17] Ibid, cl 4.4.2.
[18] Ibid, cl 4.4.1.
[19] Ibid, cl 4.4.2.

five major oil companies operating in New Zealand; Gull, BP, Caltex, Shell and Mobil. The NZ ETS would cover petrol, diesel, aviation fuels, naptha and light and heavy fuels. Lubricating oils, fuels for export purposes, international aviation or marine transport are not included in this sector. LPG and burning oil for energy are covered under the stationary sector. There is a further option under consideration, namely the option for users of jet fuel for domestic purposes (ie airlines) to voluntarily opt in to become participants with unit obligations. However, the details of this option have yet to be developed. This would cover all domestic airlines.

The NZ ETS obligations will operate parallel to the Bio-Fuels Sales Obligation, which will require a percentage of all petrol and diesel sales to consist of bio-fuel.

(b) Stationary Energy[20]

The point of obligation in the stationary energy sector will be upstream suppliers, namely importers, producers, coal-miners, geothermal electricity generators or direct users and industrial users of oil for energy. Energy sources covered include coal, natural gas and geothermal. This sector also covers urea, hydrogen, ammonia and methanol. Energy and fuels for export are not covered by the NZ ETS. Furthermore, large energy users, such as electricity generators or major industrial processors, could opt in to the scheme as direct points of obligation.

To supplement the focus on reducing emissions from the stationary energy sector, the Government has included an amendment to the *Electricity Act 1992* in the Emissions Trading Bill. This initiates a 10-year moratorium on new fossil-fuelled thermal electricity generation capacity, except as necessary for security of supply. The NZ ETS coupled with the moratorium will give effect to the Government's commitment to 90% renewable energy in the stationary energy sector by 2025.

(c) Industrial Process (Non-Energy) Emissions[21]

Producers of iron, steel, aluminium, cement, burnt lime, glass, gold and paper are the points of obligation for the industrial processes sector. Lime fertiliser producers and importers of hydro-fluorocarbons and per-fluorocarbons are also included as well as importers of sulphur hexafluoride after 1 January 2013.

The government has noted that producers in this sector who are unable to pass on costs to consumers and will suffer from reduced competitiveness, will require transitional assistance.

(d) Agriculture

Greater complexities arise in the agriculture sector. In the case of nitrogen fertilisers, it is proposed that an upstream point of obligation at the level of fertiliser producers would be suitable.[22] In the case of livestock emissions, options for the point of obligation include farmers (the upstream point), sector bodies (a midstream point) and meat/dairy processors (a different midstream point).[23] That said, the Government still wishes to engage with the agricultural sector to assess the administrative and technical feasibility of placing the point

[20] Ibid.
[21] Ibid.
[22] Ibid.
[23] Ibid.

of obligation at different points of the agricultural supply chain, and the impact of this decision on the effectiveness of incentives to reduce emissions.[24]

(e) Forestry

In this sector, the appropriate point of obligation for emissions from deforestation of pre-1990 forest land will be the landowners.[25] In some circumstances, this obligation may be transferred, namely, where the landowner can prove that control over land-use decisions had been delegated to a third party when the deforestation occurred.[26] In the case of post-1989 afforestation, emission units (with associated liabilities) would be awarded to landowners or to the forestry right holders, as appropriate, if they opted to receive them.[27]

1.9 Mandatory and Voluntary Obligations

Activities in Sched 3 of the Emissions Trading Bill give rise to mandatory obligations. Such activities include: (Pt 1) de-foresting pre-1990 forest land, other than exempt land, if the area deforested is more than 2 hectares in the five year period starting 1 January 2008; (Pt 2) owning obligation fuels; (Pt 3) importing or mining coal, natural gas or other liquid fossil fuels; (Pt 4) producing steel, aluminium, or other industrial products, and importing hydro-fluorocarbons and sulphur hexafluoride; (Pt 5) importing or manufacturing fertiliser, raising, keeping or slaughtering farm animals for profit or trade; (Pt 6) operating a waste disposal facility.

Persons who carry out activities listed in Sched 4 may elect to participate in the NZ ETS. These activities include: (Pt 1) other forestry removal activities; (Pt 2) producing a product that contains a substance that has not been combusted and if combusted would result in emissions; (Pt 3) purchasing obligation jet fuel; (Pt 4) purchasing coal or natural gas from a participant who mines coal or natural gas.

Further, the introduction of sectors will be staggered in order to allow industry to adapt. These dates are listed in Scheds 3 and 4 of the Emissions Trading Bill:

Sector	Commencement of Obligations	End of Initial Compliance Period
Forestry	1 January 2008 (or when the Act comes into force)	31 December 2009
Liquid Fossil Fuels	1 January 2009	31 December 2009
Stationary Energy	1 January 2010	31 December 2010
Industrial Process	1 January 2010	31 December 2010
Agriculture	1 January 2013	31 December 2013
Waste	1 January 2013	31 December 2013

24 Ibid.
25 Ibid.
26 Ibid.
27 Ibid.

1.10 Compliance

The New Zealand Government prefers a "self-assessment" approach to compliance, similar to that of the New Zealand tax system.[28] Participants are expected to meet their obligations without Government supervision. To ensure compliance and to bolster the integrity of the NZ ETS, an audit process will be implemented. This approach allows for lower enforcement and compliance costs and applies checks and balances only where necessary to preserve NZ ETS reputation. The Government is sensitive to the tension between market integrity and the costs of ensuring compliance, particularly in relation to international linkage issues.[29]

The administering agency will have a range of powers to ensure compliance and ease of the auditing process. Further, these powers would only be exercised in relation to ensuring compliance. The powers of the chief executive and the enforcement officers are detailed in cll 82 to 95 of the Emissions Trading Bill. These include the power to require information that is reasonable to ensure compliance,[30] to inquire and to require evidence,[31] to request an inquiry before a District Court judge,[32] to enter land or premises (with the exception of any dwelling house or marae) at any reasonable time subject to notice being given for investigation and the taking of documents and/or samples.[33]

However, these powers are limited and there are significant obligations placed on the chief executive and the enforcement officers, the most serious of which is the obligation to maintain confidentiality.[34] The chief executive and enforcement officers must keep confidential all information they receive when carrying out their official function or exercising their powers under the Emissions Trading Bill. Contravening this clause is punishable under cl 117. This obligation is crucial for the overall integrity of the NZ ETS and for safeguarding competitiveness in trade.

Other obligations include the duty to have a warrant before entering premises and seizing documents and other information,[35] provide notice of entry if an occupier is not present when entry occurs,[36] provide proof of authority when asked by an occupier,[37] and the obligation to use any information obtained under cll 89 or 90 only for proceedings for an alleged breach of an obligation under the Emissions Trading Bill.[38]

1.11 Penalties

Failure to comply with the obligations outlined in the Emissions Trading Bill will result in monetary and possibly criminal penalties. Subpart 4, cll 116 to 129 outline the offences and penalties for non-compliance. The level of wilful non-compliance or deceit determines the level of the penalty and, depending on the clause breached, participants could face a fine and/or imprisonment. If a participant fails to comply with their obligations under the Emissions Trading

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[28] Ibid, cl 4.12.1.1.
[29] Ibid.
[30] *Climate Change (Emissions Trading and Renewable Preference) Bill*, cl 83.
[31] Ibid, cl 84.
[32] Ibid, cl 85.
[33] Ibid, cl 89.
[34] Ibid, cl 88.
[35] Ibid, cl 90.
[36] Ibid, cl 92.
[37] Ibid, cl 91.
[38] Ibid, cl 93.

Bill without reasonable excuse, they commit a strict liability offence against the Act.[39] Penalties range from a fine not exceeding $8000 for first time convictions to a fine not exceeding $24,000 for repeated offending.[40] There is a marked increase in the level of fine in the Emissions Trading Framework and the level of fine included in the Emissions Trading Bill, with the fines in the Emissions Trading Bill being double what the Government initially suggested in the Framework. Willingly interfering with inquiries, knowingly altering documents or failing to submit reports or wilful failure to provide information is liable on summary conviction to payment of a fine of $25,000 for an individual and $50,000 for a body corporate.[41] If a person has intent to deceive and fails to comply with their obligations under the Act, they could face imprisonment for a term not exceeding five years, a fine not exceeding $50,000, or both.[42]

Failure to surrender units results in an additional fine and the publication of the participant's identity and the nature of the non-compliance. Under cl 121(2), if a person fails to surrender the necessary units, they must surrender or cancel the units required under the relevant clause and pay an excess emissions penalty of $30 per unit to the chief executive. If the participant knowingly fails to submit an emissions return, or provides false information on its emissions return, it will be required to pay an additional penalty of $30 for each unit the participant is liable to surrender. [43] Further, interest accrues on the excess emissions penalty with the level of interest to be set by the Governor-General by Order in Council.[44] The severity of these penalties is clearly designed to deter participants from non-compliance and provide significant incentive to uphold their obligations. This is further demonstrated in cl 122 where there is provision for reductions in penalties for voluntary disclosure.

1.12 Significant Liabilities

There are two significant liabilities in the Emissions Trading Bill that require particular reference. The first is found within cll 126-128, which determine the liability for a body corporate and establish vicarious liability in relation to a body corporate, directors, agents and employees. If a body corporate is convicted of an offence under the Emissions Trading Bill, every director and all others involved in the management of the body corporate is also guilty if it is proved that the act or omission occurred with the authority, permission or consent or the director or person or if they had knowledge of the offence and took no reasonable steps to prevent it.[45]

This liability extends to the reverse; where a body corporate, person or group of persons (the principal) is liable for an act or omission committed by a director, agent or employee on behalf of the principal.[46] Such liability is an established feature of the law but, in the context of emissions trading, it demonstrates that the Government will not tolerate non-compliance and such provisions have been designed to place personal liability on those in positions of authority.

Secondly, the Government has shown how serious it considers a breach of confidentiality to be through the inclusion of cl 117. This clause states that if the chief executive, enforcement officer, or any other person mentioned in cl 88 breaches confidentiality, they will be liable on summary

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39 Ibid, cl 116(1).
40 Ibid, cl 116(2).
41 Ibid, cl 119.
42 Ibid, cl 120.
43 Ibid, cl 123.
44 Ibid, cl 124.
45 Ibid, cl 127.
46 Ibid, cl 128.

conviction to a fine not exceeding $15,000, imprisonment for a term not exceeding six months, or both.[47] This clause should give industry confidence that the government is safeguarding competitiveness and protecting the information they provide to the administering agency.

1.13 Reliance on Regulation

The Emissions Trading Bill leaves some significant detail of the NZ ETS to be determined by regulation. Clause 148 outlines some of the purposes for which the Governor-General, by Order in Council, may make in regards to the NZ ETS. Under clause 68, allocation plans for free allocation of units, or grand-parenting, may be made by the Governor-General, by Order in Council and made on the recommendation of the Minister.

This is a politically convenient method of leaving a controversial issue until after the 2008 election. Postponing the decision on grand-parenting of units also means that such controversial issues will not be debated in the Select Committee process or be subject to public scrutiny in the same manner as the Emissions Trading Bill. However, the Regulations Review Committee provides a safeguard for such situations. Standing Order 315(2) allows the Committee to examine all regulations and to draw the special attention of the House of Representatives to any regulation it considers "contains matter more appropriate for parliamentary enactment".

1.14 Allocation and Trading of Units

The primary unit of trade will be the "New Zealand Unit". Under the scheme, one New Zealand Unit must be surrendered for one tonne of emissions. The Government does not intend to determine how the units will be traded and the Bill reflects this. This gives the NZ ETS a level of flexibility unmatched by any other scheme. Credits can be traded on the New Zealand Stock Exchange TZ1 carbon trading platform, or through a simple bilateral trade. As the scheme develops, the Government expects to see secondary traders enter the market and use their expertise to match buyers and sellers, similar to stockbrokers.

The allocation of units has been a contested area. There have been concerns from environmental groups and NGOs that any grand-parenting in the NZ ETS will be nothing more than a way for polluters to make quick profits from a global concern. Grand-parenting occurs when polluters are given free allocation of credits based on their historical emissions.

1.15 International Linkage

Direct bilateral linking with an ETS in another country or region implies that the unit of trade in the two different schemes are fully fungible (ie valid for compliance in each scheme).[48] This kind of linking requires some degree of conformity between the design features of the respective trading schemes.[49]

One of the key advantages of an ETS is that it is consistent with the nature of New Zealand's international obligations (the Kyoto Protocol being a global cap-and-trade system).[50] More generally, there is considerable strategic and economic benefit in taking the same broad approach

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47 Ibid, cl 117.

48 *The Framework for a New Zealand Emissions Trading Scheme*, New Zealand Ministry for the Environment and The Treasury, September 2007, cl 4.7.1.1.

49 Ibid.

50 *Climate Change (Emissions Trading and Renewable Preference) Bill*, Explanatory Note, p 27.

to reducing emissions as some of our key trading partners.[51] By internationally linking the NZ ETS, trading can occur in the much larger and more liquid international market. This effectively allows NZ firms to take advantage of low cost abatement opportunities offshore.[52]

The potential for a direct bilateral agreement between New Zealand and another country or region prior to 2012 is currently limited.[53] Nevertheless, the Australian Government's ratification of the Kyoto Protocol (discussed below) and its plans to introduce a national Emissions Trading Scheme is of major interest to New Zealand given the close economic relationship between the two countries.

2. PART TWO: IMPLICATIONS FOR AUSTRALIA / NEW ZEALAND BILATERAL TRADE, AND THE CER TREATY

2.1 The New Australian Position in Relation to Emissions Trading

Before looking at the Australia New Zealand Closer Economic Relations Trade Agreement (the ANZCERTA, or as it is more commonly called, the "CER treaty") and its obligations in respect of bilateral trade, the new Australian position in relation to emissions trading is noted and the tension between trade obligations and emissions trading schemes and how that might impact on New Zealand and Australian bilateral trade is discussed.

Although the former Howard Government refused to ratify the Kyoto Protocol, the Government still announced plans for an Australian Emissions Trading Scheme (the AU ETS) on 17 July 2007. The scheme is set to commence no later than 2012 and is stricter than the European Union Emissions Trading Scheme (the EU ETS). The AU ETS will be a cap-and-trade scheme and will initially exclude agriculture, land use and waste sectors.

However, on 3 December 2007, the newly elected Labor Party's first official act was to ratify the Kyoto Protocol. The new Prime Minister, Kevin Rudd, said the Federal Government will do everything in its power to help Australia meet its Kyoto obligations, including setting a target to reduce emissions by 60% on 2000 levels by 2050.[54] Australia will also establish a national emissions trading scheme by 2010 and set a 20% target for renewable energy by 2020.[55]

The fact that Australia has recently become a party to the Kyoto Protocol means that New Zealand might be able to accelerate indirect linkage through the Kyoto mechanisms. The impact of such a move on existing trade relation agreements between New Zealand and Australia is discussed in more detail below.

2.2 ANZCERTA

New Zealand and Australia are both members of the World Trade Organisation (WTO), and as such, they each have obligations to reduce barriers to trade. ANZCERTA is a prime example of two member states performing such an obligation. However, ANZCERTA is more than just a free trade agreement; its scope covers all aspects of the Australia – New Zealand trade and economic

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[51] Ibid.
[52] Ibid.
[53] *The Framework for a New Zealand Emissions Trading Scheme*, New Zealand Ministry for the Environment and The Treasury, September 2007, cl 4.7.1.1.
[54] http://www.smh.com.au/news/environment/rudd-clinches-kyoto/2007/12/03/1196530553203.html.
[55] Ibid.

relationship.[56] As well as underpinning bilateral trade in goods and services, the ANZCERTA is the umbrella for close collaboration across quarantine, customs, transport, regulatory and product standards and business law issues.[57]

The objectives of the ANZCERTA are to:[58]

- strengthen the broader relationship between Australia and New Zealand;
- develop closer economic relations between Australia and New Zealand through a mutually beneficial expansion of free trade between the two countries;
- eliminate barriers to trade between Australia and New Zealand in a gradual and progressive manner under an agreed timetable and with a minimum of disruption; and
- develop trade between New Zealand and Australia under conditions of fair competition.

Australia is a significant investment destination for New Zealand, and New Zealand ranks third as an investment destination for Australia.[59] The ANZCERTA represents the main government to government agreement governing economic relations between the two countries. Significantly, it has been recognised by the WTO as a model free trade agreement.[60]

In the 20 plus years since ANZCERTA came into effect, two way trade in goods has expanded at an average annual growth rate of 9%. While no consecutive compatible investment data is available for the entire period, it is estimated that between 1983 and 2003, two way investment increased at an annual average rate close to 18.6%.[61] ANZCERTA is also a living document that is reviewed periodically, with meetings also held annually between the trade ministers of Australia and New Zealand to discuss trade issues and cooperation to promote ANZCERTA's effectiveness.[62]

The importance of ANZCERTA must not be underestimated. Since its establishment, substantial progress has been made in integrating the Australian and New Zealand economies – in trade, investment, the flows of people and regulatory approaches.[63] Under the ANZCERTA, a number of tariffs and quantitative restrictions have been removed, with the suppliers of goods and services from both countries being treated on a similar basis.[64] Business law has also become more coordinated.[65] The list of core ANZCERTA documents is impressive. [66]

The Memorandum of Understanding (MOU) on the Harmonisation of Business Law signed in 1988 provided the starting point for dialogue between Australia and New Zealand on business law issues.[67] In August 1999, Australian and New Zealand officials agreed to revise the existing MOU

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56 http://www.fta.gov.au/default.aspx?FolderID=284.
57 Ibid.
58 Article 1 of the Australia New Zealand Closer Economic Relations Trade Agreement (ANZCERTA).
59 http://www.fta.gov.au/default.aspx?FolderID=284.
60 Ibid.
61 Ibid.
62 Ibid.
63 *The Australia – New Zealand Closer Economic Relationship*, The Ministry of Foreign Affairs and Trade, 2005, p 31.
64 Ibid.
65 Ibid.
66 See Appendix One for the list of Core CER Documents.
67 Ibid, p 28.

to ensure that it reflected Australia's and New Zealand's common understanding of coordination in business law, key objectives for progressing work in this area, and a revised work program.[68]

The MOU on the Coordination of Business Law was subsequently signed in August 2000. This MOU is focused on coordination and recognition that one single approach is not necessarily suitable for every area.[69] Since the signing of the MOU, coordination of competition law, securities law and takeovers law has been extensive.[70] Work is proceeding on consumer protection law, electronic transactions law, disclosure regimes, cross border insolvency and intellectual property rights.[71]

The focus of New Zealand – Australia closer economic relations is now fixed on identifying, developing and implementing reforms that seek to progress the development of this relationship in order to create a seamless trans-Tasman business environment – a Single Economic Market (SEM) between New Zealand and Australia.[72]

The concept of a SEM between New Zealand and Australia was first unveiled at government to government level at the January 2004 annual meeting between Australian Treasurer Mr Peter Costello and New Zealand Finance Minister Dr Michael Cullen.[73] The two Ministers agreed to a number of initiatives relating to banking supervision and improved cooperation and coordination on competition policy, with the long term goal of enabling a properly constituted Australian company to function as a company in New Zealand as of right, and vice versa.[74] These comments were endorsed at a meeting between Helen Clark and John Howard on 3 March 2004.[75]

The current SEM work program spans a broad range of regulatory and policy areas with potentially wide implications for business. Current initiatives cover business law and regulation, taxation, prudential regulation of banking, industry policy coordination, intellectual property, market access (rules of origin), investment policy, border processes, people links and the skills base.[76]

In May 2004, the Australia New Zealand Leadership Forum (Forum) was established. Its purpose was to create a stronger relationship between the two countries and build on very good existing relationships amongst governments, companies, interest groups and people within the two countries.[77] In the course of the second Forum meeting in April 2005, it was determined that in an increasingly globalised world it was essential to target impediments in areas like banking and taxation, in order to create a more efficient business environment that would allow both economies to compete successfully in regional and international markets.[78]

At the time of the ANZCERTA's inception and the subsequent MOUs on Business Law Harmonisation and Coordination of Business Law and the development of the current SEM

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68 Ibid.
69 Ibid.
70 Ibid.
71 Ibid.
72 *The Australia – New Zealand Closer Economic Relationship*, The Ministry of Foreign Affairs and Trade, 2005, p 31.
73 Ibid.
74 Ibid.
75 Ibid.
76 Ibid, p 32.
77 Ibid, p 33.
78 Ibid.

program, no firm commitment to an ETS had been made by either country. Unsurprisingly, there are no specific provisions in ANZCERTA, the MOUs or the current SEM program for consultation in relation to the harmonisation of and/or joint implementation of each country's ETS. However, the progress made in respect of the integration of the Australian and New Zealand economies establishes a firm basis for cooperation between respective Governments in the design and implementation of a domestic ETS.

To date, no major joint initiatives have been undertaken by either country to further such a scheme, but with the recent change of Australian Government, and the long history of cooperation between New Zealand and Australia in respect of policy initiatives and international matters generally, it is likely that joint implementation will be a beneficial option for both. Indeed, during the first official meeting between Prime Ministers Helen Clark and Kevin Rudd, Mr Rudd stated that with Australia and New Zealand both having fully ratified the Kyoto Protocol, the two countries now had "an unprecedented opportunity to work closely, seamlessly, globally" on climate change.[79]

2.3 The Tension Between Free Trade Agreements and Emissions Trading Schemes

It has been suggested by some economists that environmental measures introduced by nations are in direct conflict with the WTO principles and free trade agreements (FTAs) of reducing tariffs and other barriers to trade (a concept also referred to as "disguised protectionism").[80]

The WTO principles relating to trade without discrimination, free trade, predictability through binding and transparency, promoting fair competition, and encouraging development and economic reform as implemented by the WTO agreements[81] and FTAs have a wide enough scope to ensure that environmental measures introduced by individual nations do not unduly restrict exports, but a balance is needed between safeguarding market access and protecting the environment. Governments must have the right to implement environmental measures (especially where they have ratified the Kyoto Protocol and are subject to treaty commitments which can only be implemented by environmental measures) but they must not unnecessarily impede trade in a manner which is inconsistent with their trade obligations (whether as WTO member or as a party to an FTA (such as ANZCERTA)).

It is certainly possible to take the view that an emissions trading scheme does implement trade barriers. Such a scheme effectively decreases the international competitiveness of carbon-intensive products and services. By placing a carbon price on these products and services, the price is driven up and demand is likely to decrease. Carbon prices create winners and losers in trade, while the WTO principles are designed to create a level platform in trade.

On the other hand, it can be argued that environmental measures (such as an emissions trading scheme) are necessary to reduce carbon emissions as a means of rectifying a market failure. As

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79 http://www.stuff.co.nz/4418116a10.html.

80 See by way of example, the discussion in *Trade and the environment: The risks and opportunities for New Zealand associated with the relationship between the WTO and multilateral environmental agreements*, Report produced for the New Zealand Ministry for the Environment, Dr Suzi Kerr, Motu: Economic & Public Policy Research and Dr Elizabeth R DeSombre, Frost Associate Professor of Environmental Studies and Associate Professor of Political Science, Wellesley College 17 June 2001; *Framework for Integrating Environmental Issues into Free Trade Agreements*, New Zealand Ministry of Foreign Affairs and Trade, see http://www.mfat.govt.nz.

81 http://www.wto.org/english/theWTO_e/whatis_e/tif_e/fact2_e.htm.

stated in the Stern Review, "climate change presents a unique challenge for economists: it is the greatest and most wide-ranging market failure ever seen" .[82] The cost to the environment has never truly been incorporated into the price of products and services, and the global environment has suffered as a result of that failure. Carbon pricing, through taxation, emissions trading or regulation, is designed to show people the full social costs of their actions.

Emissions trading schemes can nurture new low-carbon industries and increase opportunities in trade whilst decreasing others. As long as reasonable standards are set and exporters are able to meet those standards, it is difficult to argue that the balance is skewed towards environmental protectionism. When all measures for reducing carbon emissions are compared, emissions trading schemes are arguably the most compatible with the WTO principles and FTA obligations. This is due to their ability to increase prices rather than restrict trade altogether.

Tradeable emission permits are still a new area of international policy, and questions to be addressed include whether tradeable emission schemes even fall under the WTO General Trade Agreement on Trade in Services[83] and the ambit of any particular FTA. Although there are still a number of questions surrounding such schemes, commentators have suggested that the potential exists for a number of important aspects of the key provisions of the WTO (and hence, FTAs such as the ANZCERTA) may have to be revisited with a need to the tension referred to above.[84]

2.4 Implications for Australia and New Zealand Bilateral Trade

The tension between WTO principles and FTA obligations on one hand, and emissions trading schemes on the other, as discussed above, illustrates the potential impact on Australian and New Zealand bilateral trade and ANCERTA. There is the potential for disguised protectionism ie the costs of goods and services subject to bilateral trade to increase by reason of sector participants being subject to a domestic ETS making those goods or services either more or less expensive than alternative sources of supply (depending on the cost of environmental measures faced by those alternative sources of supply).

If, due to New Zealand and Australia implementing their ETSs at different times, goods and services exported from New Zealand into Australia become more expensive than either Australian produced goods or services, or the same goods or services produced by New Zealand's trade competitors, then the implications for New Zealand exporters are obvious. There is also the potential that once both the NZ ETS and the AU ETS are in place, a price difference between New Zealand units and Australian units may exacerbate or mitigate the foregoing implications. However, it is fair to say that these potential implications have been recognised by the New Zealand Government in the preliminary design of the NZ ETS set out in the Framework, which is to be developed by regulation under the Emissions Trading Bill. Once enacted, the firms who face international competition will have the benefit of some degree of free allocation of New Zealand units.[85] The Government has decided in principle to move towards a zero level of free allocation by 2025 with a linear rate of decline from 2013-2025.[86] Hence by way of example, the New Zealand agriculture sector, being New Zealand's primary export sector, will not be brought into

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82 *Stern Review: The Economics of Climate Change*, Full Executive Summary, p 1.

83 Gary P Sampson (former Director of the Trade and Environment Division of the WTO), *WTO Rules and Climate Change: The Need for Policy Coherence*, p 38.

84 Ibid.

85 *The Framework for a New Zealand Emissions Trading Scheme*, New Zealand Ministry for the Environment and The Treasury, September 2007, cll 5.2.12, 5.2.13 and 5.3.

86 Ibid, cl 5.3 (vi).

the NZ ETS until 2013 and will be provided with a free allocation pool of New Zealand units equal to 90% of 2005 emissions. The free allocation will decrease on a linear basis so as to phase out this form of assistance completely by 2025.[87]

ANZCERTA has relevance in this context as in the event of disguised protectionism (whether deliberate or accidental), the ANZCERTA objectives of mutual beneficial experiences of free trade and elimination of barriers between Australia and New Zealand can form a basis for political intervention.

Furthermore, it must be in both Australia and New Zealand's interests (but undoubtedly more in New Zealand's interests) to ensure that the AU ETS and the NZ ETS are harmonised and Australian and New Zealand units are internationally tradeable without impediment so as to maximise the liquidity of their respective markets. The ANZCERTA provisions as to harmonisation of business laws and the subsequent MOU on Harmonisation of Business Law, whilst not directly relevant,[88] can be brought to bear as a basis for harmonisation of the AU ETS and NZ ETS schemes. The MOU states:

> "Both Governments also recognise that differences in the laws and regulatory practices relating to business may impede the enhancement of this relationship by inhibiting the creation of an environment conducive to the growth in trade of goods and services and the efficiency of both economies."[89]

Furthermore, the MOU also states:

> "When either Government considers that a difference between their respective business laws or regulatory practices gives rise to an impediment to trade, and requests consultations, the two Governments will consult with a view to resolving the impediment, whether the area of law is already included on the program and regardless of the priority accorded to the matter at the time."[90]

However, it does require political will for both the Australian Federal and New Zealand Governments to take steps to implement this objective in the ETS context, and it can be queried whether in this context, there is any such political will.

3. CONCLUSION

Both New Zealand and Australia are well on the way to establishing their own Emissions Trading Schemes. It is currently unclear as to whether or not these schemes can or will be linked, but the ANZCERTA is unlikely to act as a singular vehicle which will influence the development of either the New Zealand or Australian ETS. The other policy agreements between New Zealand and Australia referred to in Appendix One may in fact be more suitable to assist in this process if there is the political will to implement them; and, very recent events suggest that this political will exists. Further, there is a strong incentive on each Government to permit compatibility so as to facilitate trading between New Zealand and Australian "carbon units" and ensure the New Zealand/Australian markets obtain maximum liquidity. Accordingly, the sectors to be subject to

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[87] Ibid, cl 5.3.1.

[88] See Appendix Two for a summary of the scope of the MOU on Harmonisation of Business Law.

[89] *Memorandum of Understanding Between the Government of Australia and the Government of New Zealand on Harmonisation of Business Law*, cl 2.

[90] Ibid, cl 7.

obligations under the New Zealand ETS can expect significant harmonisation between the New Zealand and Australian ETS regimes and the consequential advantages.

APPENDIX ONE – LIST OF CORE CER DOCUMENTS

Exchange of Letters

Furniture (1984 & 1985)

Tomatoes (1984)

Canned Fruit (1984)

Import Tariffs (1984)

Wheat Flour (1984)

Access Prices (1984)

Trade between Individual Firms (1984)

Gloves, Mittens, Mitts (1985)

Wool Carpet (1985)

Tyres (1985)

Import Quotas (1985)

Rubber (1986)

Customs Tariffs (1987)

Export Quotas (1988)

Dairy (1988)

Annex F (1992)

Third Country Dumping (1992)

Rules of Origin (1992)

Direct Shipment (1992)

Industry Assistance (1992)

Investment and Taxation (1996)

Services Protocol

Protocol on Trade in Services to the ANZCERTA (1988) Inscription Amendment Letters

Trade Protocol

Protocol to the ANZCERTA on Acceleration of Free Trade in Goods (1988)

Quarantine Protocol

Protocol on Harmonisation of Quarantine Administrative Procedures to the ANZCERTA (1988)

Standards

Agreement between the Government of Australia and the Government of New Zealand and the Governments of the States and Territories on Standards, Accreditation and Quality (1990)

Agreement between New Zealand and Australia Concerning the Establishment of the Joint Accreditation System of New Zealand and Australia (JAS-ANZ) (1991) (replaced with the 1998 Agreement)

Exchange of Letters Regarding the Status of JAS-ANZ as an International Organisation

Memorandum of Understanding Concerning Cooperation on Standards and Conformance between ASEAN and CER (1996)

Agreement between Australia and New Zealand Concerning the Establishment of the Governing Board, Technical Advisory Council And Accreditation Review Board of the Joint Accreditation System of Australia and New Zealand (1998)

Food Standards

Agreement between the Government of New Zealand and the Government of Australia Establishing a System for the Development of Joint Food Standards (1995)

Exchange of Letters Regarding Implementation of the Treaty (1995)

Exchange of Letters Regarding the Establishment of a Food Inspection Programme (1996)

Exchange of Letters Amending the Joint Food Standards Treaty (2001)

Agreement between the Government of Australia and the Government of New Zealand Concerning a Joint Food Standards System (2002)

TIMRA

Arrangement between the Commonwealth of Australia, Australian States and Territories and New Zealand Relating to Trans-Tasman Mutual Recognition (1996)

Government Procurement

Australia and New Zealand Government Procurement Agreement (1997)

Agreed Minute on State Government Purchasing Preferences (1988)

Technical Barriers to Trade

Memorandum of Understanding between the Government of New Zealand and the Government of Australia on Technical Barriers to Trade (1988)

Exchange of Letters Clarifying the Role of the TBT Agreement (1992)

Business Law

Memorandum of Understanding between the Government of New Zealand and the Government of Australia on Harmonisation of Business Law (1988)

Memorandum of Understanding between the Government of New Zealand and the Government of Australia on Coordination of Business Law (2000)

Securities

Memorandum of Understanding between the Australian Securities Commission and the Securities Commission of New Zealand (1994)

Aviation

Confidential Memorandum of Understanding Regarding Australia/New Zealand Air Service Discussions (1988)

Memorandum of Understanding Concerning Air Services between Australia and New Zealand (1989)

Memorandum of Understanding Concerning Air Services between Australia and New Zealand (1992)

Australia and New Zealand Single Aviation Market Arrangements (1996)
Memorandum of Understanding on Open Skies between Australia and New Zealand (2000)

Agreement between the Government of New Zealand and the Government of Australia Relating to Air Services (2002)

Customs

CER Review Joint Understanding on Harmonisation of Customs Policies and Procedures (and Exchange of Letters) (1988)

Cooperative Arrangement between the Government of New Zealand and the Government of Australia Regarding Mutual Assistance Between their Customs Administrations (1992) (replaced by the 1996 Agreement)

Taxation

Agreement Between the Government of New Zealand and the Government of Australia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (1995)

APPENDIX TWO – SUMMARY OF THE SCOPE OF THE MOU FOR HARMONISATION OF BUSINESS LAW

As provided for under cl 5 of the MOU, the program of Harmonisation will include the following areas:

(a) companies, securities and futures laws;

(b) competition law, including in particular reliance on competition law to redress predatory trade between both countries;

(c) consumer protection, particularly with respect to post-sale consumer protection, and consumer credit laws; copyright law, including support of appropriate international conventions, and the protection of computer software and integrated circuits;

(d) commercial arbitration;

(e) the law relating to the sale of goods and services between the two countries;

(f) mutual assistance between regulatory agencies in the administration and enforcement of business laws;

(g) Further recognition and reciprocal enforcement of court decisions in each country, including enforcement of injunctions, orders for specific performance and revenue judgments.