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Office of the Minister of Climate Change**DEV - Cabinet Economic Development Committee****International Carbon Market Cooperation to Reduce Emissions and Complement Domestic Action****Proposal**

- 1 This paper responds to Cabinet's invitation to the Minister of Climate Change to report back to Cabinet (CAB-21-MIN-0435refers). This report back follows from the report back in November 2022 on progress made in developing a portfolio of options for international cooperation to access offshore mitigation to supplement domestic action to meet the first Nationally Determined Contribution (NDC 1) under the Paris Agreement.
- 2 This paper reports on further work that has been completed and signals that I expect to seek decisions in the first half of 2023 on:
 - 2.1 the objectives for international carbon market cooperation that will guide the development of a portfolio of offshore emissions reductions;
 - 2.2 criteria that the portfolio must meet and criteria that will be used to determine the mix of sources that will make up the portfolio;
 - 2.3 funding arrangements for purchasing the portfolio, s 9(2)(j) and to implement; and
 - 2.4 the functions required to develop and manage the portfolio (including the functions Cabinet wishes to retain and those it wishes to delegate) and the institutional arrangements needed to deliver these functions.

Relation to government priorities

- 3 The Government passed the Climate Change Response (Zero Carbon) Amendment Act in 2019 and declared a climate change emergency on 2 December 2020. [CBC-20-MIN-0097 refers]. The Act established the Climate Change Commission and mandated it to prepare domestic emissions budgets. The Government agreed to the first emissions budgets in April 2022 and the first Emissions Reduction Plan (ERP) in May 2022 which sets out actions to achieve the emissions budgets. In 2022 Cabinet agreed to the International Engagement Plan that sets out New Zealand's priorities for global ambition,

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investment in and support for resilience in the Pacific, and to support New Zealand's transition to a low emissions future.

- 4 New Zealand is a party to the Paris Agreement and has communicated the first Nationally Determined Contribution (NDC 1) that is aligned with limiting global warming to 1.5 degrees Celsius and that represents the highest possible ambition consistent with Article 4.3 of the Paris Agreement.
- 5 NDC 1 requires more emissions reductions than will be achieved solely through the Emissions Reduction Plan (ERP) and domestic emissions budgets over the period to 2030.
- 6 While every effort will be made to meet or exceed the emissions budgets, it will be necessary to supplement these efforts through cooperation with others to reduce emissions offshore. International cooperation aims to contribute our fair share to the global effort and to manage impacts on New Zealanders and the New Zealand economy.
- 7 International cooperation to reduce emissions will complement other actions that the Government continues to take and is planning to take to address climate change, including New Zealand's Emissions Trading Scheme reform.
- 8 s 6(b)(i)

Executive Summary

- 9 This paper responds to Cabinet's invitation to report back on policy matters to progress efforts for accessing offshore mitigation, with a view to meeting NDC1.
- 10 This paper is in the context of Cabinet's decision in October 2021 that the Minister of Climate Change will oversee the development of a strategic portfolio approach for the international cooperation component of the plan to meet NDC 1 (CAB-21-Min-0435 paragraph 13 refers).
- 11 This work will culminate in an NDC strategy that will be implemented through the Emissions Reduction Plan dealing with domestic emissions and the International Emissions Reduction Plan dealing with international cooperation to reduce emissions.
- 12 This paper describes five matters on which officials are working to develop the portfolio of options for international cooperation and that will form part of the International Carbon Markets Plan. This paper also signals further decisions for which I expect to seek Cabinet agreement by June 2023. The five matters and associated decisions are:
 - 12.1 Objectives for international cooperation: whether these should be expressed in quantitative or qualitative terms?

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- 12.2 Types of international cooperation available: whether any particular types should be prioritised over others?
 - 12.3 Criteria that the portfolio must meet to achieve the objectives: which criteria should be applied?
 - 12.4 Funding arrangements: s 9(2)(f)(iv)
[Redacted]
 - 12.5 Functions and institutional arrangements: whether Cabinet wishes to retain all functions within Government or devolve some to the private sector, and whether a new public sector entity is needed with the skills and experience to build and operate the international portfolio?
- 13 I have asked officials to provide advice on these matters including decisions that I expect to seek from Cabinet to develop and implement the International Emissions Reduction Plan.

Background

- 14 In October 2021 Cabinet noted that [CAB-21-MIN-0435 refers]:
- 14.1 the Paris Agreement recognises that countries will cooperate to reduce emissions and deliver greater ambition;
 - 14.2 NDC 1 was set on the basis that it would be achieved through a mix of domestic emission reductions, forestry removals and international cooperation;
 - 14.3 The Climate Change Commission advised that access to offshore mitigation will be needed to deliver NDC1 cost-effectively, in addition to domestic action;
 - 14.4 There is a wide range of international cooperation options that are possible, with varying levels of readiness, risks and co-benefits; and
 - 14.5 By developing a diverse portfolio of international cooperation options the Government can manage and spread delivery, ensure environmental integrity, and manage risks.
- 15 Cabinet also agreed to update New Zealand's position on international cooperation (CAB-18-MIN-0248 refers) to confirm that:
- 15.1 New Zealand's first priority will be domestic climate action to help meet New Zealand's climate change targets;
 - 15.2 In addition to transitioning the economy and taking domestic action, New Zealand plans to use offshore emissions reductions with environmental integrity towards NDC 1;

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- 15.3 New Zealand will be seeking a range of potential options for sourcing offshore mitigation with environmental integrity and prioritising partnering with countries in the Asia-Pacific region in ways that promote sustainable development outcomes and resilience; and
- 15.4 New Zealand will also explore reopening the New Zealand ETS to international markets with environmental integrity through ETS linking.
- 16 Cabinet agreed that the Minister of Climate Change will oversee the development of a proposed strategic portfolio approach for the international cooperation component of the plan to meet NDC1. Cabinet invited me to report back in 2022 on progress made in developing a portfolio of options for international cooperation to access offshore mitigation.
- 17 I reported back in November 2022 on progress to develop a portfolio approach to international cooperation. The report back noted that:
- 17.1 s 6(a)
- 17.2 in addition to efforts to identify viable cooperation opportunities in the Asia-Pacific region, s 6(a)
- 17.3 I expect to return to Cabinet in early 2023 to seek final approval s 6(a)
- 17.4 I intend to develop a strategy to achieve NDC 1 and that the Emissions Reduction Plan and the International Emissions Reduction Plan will be the primary means to implement the strategy.
- 17.5 I expect to report back to Cabinet in the first half of 2023 on the NDC strategy and to seek final decisions to implement the International Carbon Markets Plan including guidance on the entity or entities that will be responsible for oversight of the International Emissions Reduction Plan and where responsibility will lie for management and implementation of the portfolio of sources of international emissions reductions.
- 18 The analysis below provides more detail on the matters in paragraph 12 above and signals the decisions that will be needed from Cabinet by June 2023.

Analysis

- 19 A report from Ernst & Young (EY) commissioned by MFAT provides advice on the approach New Zealand could take to use international carbon markets to build a portfolio of emissions reductions to meet the first Nationally Determined Contribution (NDC 1) under the Paris Agreement.

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- 20 The report provides guidance on potential objectives for international cooperation, types of international cooperation available, criteria that the portfolio must meet to achieve the objectives, funding arrangements, and institutional arrangements. The report also outlines the nature, scope, and timing of actions and decisions needed to enable participation in international carbon markets.
- 21 The recommendations below represent my consideration of the findings of the EY report together with advice from officials.

International carbon market objectives

- 22 In December 2019 Cabinet agreed high-level ICM objectives and principles in New Zealand's Framework for International Carbon Market Cooperation [CAB xxx refers]. Cabinet has also agreed to prioritise cooperation that provides sustainable development co-benefits in the Asia-Pacific region.
- 23 The Framework objectives are:
- 23.1 Contributes to incentivising ambitious climate action both domestically and internationally.
- 23.2 Promotes transparent, rules-based carbon markets with environmental integrity.
- 23.3 Aligns with New Zealand's wider political and economic relationship with partners (Cabinet's additional prioritisation of cooperation that promotes sustainable development in the Asia-Pacific region fits within this broader objective).
- 23.4 Approach is in partnership with Māori, per Te Tiriti o Waitangi.
- 23.5 Does not undermine the stability or credibility of the New Zealand Emissions Trading Scheme ('ETS') or remove flexibility and does not undermine incentives for domestic abatement.
- 24 Subsequent work by officials to investigate opportunities for international cooperation consistent with these objectives shows that:
- 24.1 Some developing countries in the Asia-Pacific region (refer paragraph 18 above) are interested in bilateral cooperation with New Zealand to reduce emissions. s 9(2)(j)
- 24.2 Cooperation might be possible with developed countries in the Asia-Pacific s 6(a) to invest in projects in third countries.
- 24.3 Investment in 'off-the-shelf' emissions reductions from a central source such as the UNFCCC or from projects administered by international

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carbon funds s 6(b)(ii)

- 24.4 Backstop ETS linking arrangements offer a prudent means to manage the risk that other sources may not deliver the volume of emissions reductions required at the time they are needed and at an acceptable cost.
- 25 In order to meet NDC 1 we should be working toward a clear objective such as a target for the volume of emissions reductions required by 2030. A target will help inform decisions about what to include and what to exclude from the portfolio. The objective could be quantitative or descriptive.
- 26 As a signatory of the Paris Agreement, New Zealand has made a commitment under the UNFCCC to demonstrate that we are “on track” toward achieving the NDC in regular reporting on annual progress in the delivery of emissions reductions.
- 27 I have asked officials to provide advice on options for how that objective could be formulated. I have also requested advice on whether additional objectives might be useful. For example, that the portfolio: allows for the use of different sources of finance to increase the potential size and impact, and/or makes best use of New Zealand expertise and creates opportunities for New Zealand technologies and the private sector, and/or minimises programme expenses and allows for the effective allocation of public resources.

Types of cooperation

- 28 Different types of international cooperation on emissions reductions are possible. The analysis by EY identifies six types of international cooperation:
- 28.1 bilateral cooperation to develop new emissions reduction projects
 - 28.2 long-term large-scale partnerships to accelerate action beyond the host's NDC
 - 28.3 new projects implemented using existing methods and processes
 - 28.4 investment in carbon funds
 - 28.5 bilateral purchase of already-generated reductions, and
 - 28.6 linking the NZ ETS with other countries' ETSS.
- 29 These types of cooperation vary in terms of effort required, volume available, timing of delivery, and cost (see Appendix 1). My aim is to construct a portfolio that enables us to secure the volume required spread over time (2024-2030), at an acceptable cost and consistent with Cabinet's priorities for accessing offshore mitigation.
- 30 My report back to Cabinet in November (Cab 189 refers) noted that many countries have begun to put in place the institutional frameworks and

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cooperation agreements needed to operationalise international carbon markets. s 6(a)

- 31 This means that competition for international cooperation opportunities will increase and early movers will have an advantage in securing their required volumes at an acceptable cost.
- 32 Given the scale of New Zealand's need for offshore mitigation, it will be important to engage with sources that have the potential to supply the volume of emissions reductions required and to make the decisions needed to deliver these reductions and transfer them to New Zealand before 2030.
- 33 I have asked officials to provide advice on whether we should prioritise these types of cooperation or investigate all simultaneously.

Portfolio and source criteria

- 34 To construct a portfolio of offshore mitigation, officials will need to decide which sources of emissions reductions should be included. They will also need to determine the optimal mix of sources; that is, what combination of sources will deliver the emissions reductions required at the time they are required and at an acceptable cost.
- 35 I expect that the process to build and manage the portfolio will be iterative and adaptive. As projects or sources become available and the criteria are applied to determine eligibility for the portfolio, the portfolio will change. Initially the aim will be to build the portfolio to the point where sufficient volume is available over time that meets our minimum requirements. As some projects terminate and new projects or sources start delivering, the portfolio will adapt and change.
- 36 I have asked officials to provide advice on which criteria to use, how they should be applied, and how they will interact with the portfolio objectives and the types of cooperation. Officials will also consider whether they might change as we progress toward 2030 and we have greater certainty about domestic reductions and offshore requirements.

Funding

- 37 Funding requirements to deliver New Zealand's portfolio of ICM cooperation has three components: funding for purchasing offshore emissions reductions, s 9(2)(j) and funding implementation costs.

- 38 s 9(2)(f)(iv)

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§ 9(2)(f)(iv) [Redacted]

[Redacted]

[Redacted]

[Redacted]

39 I have asked officials to assess these and provide advice § 9(2)(f)(iv)
[Redacted]

40 § 9(2)(j)
[Redacted]

[Redacted]

[Redacted]

[Redacted]

41 Funding for the costs of implementation that are a core government responsibility (such as diplomatic efforts, management of the portfolio, review, data and forecasting) will depend on decisions about the functions required to build and manage the portfolio. § 9(2)(f)(iv)
[Redacted]

Functions and institutional arrangements

42 Several functions will be needed to build and manage the portfolio. These include:

- 42.1 Governance: responsibility for delivery of the portfolio.
- 42.2 Portfolio management: making decisions about transactions that will achieve the portfolio objectives and operational decisions.
- 42.3 Review: checking that portfolio management meets the governance requirements and that projects and sources meet the relevant criteria.

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- 42.4 Data and forecasting: data analysis and forecasting to support portfolio management, including risk management.
- 42.5 Implementation: carrying out due diligence and execute transactions that will deliver the portfolio.
- 43 Delegation of decision-making is a critical part of the setup of any organisation to allow it to operate effectively. I have asked officials to undertake further work and provide advice on the extent to which these functions exist in the public sector, where they are located, and how best they might be co-ordinated to deliver the ICM portfolio.
- 44 A critical decision will be about the role of Cabinet in decisions relating to the portfolio management of offshore mitigation.
- 45 For example, if Cabinet retains operational decisions then the extent to which new public sector entities and/or institutional arrangements are needed would be reduced. Regular Cabinet processes and some Ministerial delegations could continue to be the modus operandi. The functions that are not taken by Cabinet will either be picked up by existing public sector entities (potentially with revised policy mandates) or a new entity (or even entities) could be created to work on specific offshore mitigation tasks. I have asked officials to provide advice on these matters.

Engagement with Māori

- 46 MfE officials together with MFAT and MPI are exploring options for engagement with Iwi / Māori and with stakeholders on the way New Zealand will utilise international cooperation to meet NDC targets.

- 47 s 9(2)(g)(i)

Interactions with other climate work programmes

- 48 The NZ ETS review is a work in progress that will proceed in parallel with the International Carbon Markets work programme. Decisions about sources of offshore mitigation, whether purchasing is a government function or for the private sector, and the costs of offshore mitigation will determine whether and how these might interact with the operation of the ETS.
- 49 Similarly, Cabinet has yet to make decisions about pricing agricultural emissions following conclusion of the consultation process and subsequent advice on a preferred pricing mechanism. These decisions will determine the nature and scope of any interaction with the International Emissions Reduction Plan

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Financial Implications

- 50 There are no direct financial implications from the decisions in this paper. Direct costs will include purchasing offshore emissions reductions, s 9(2)(j) and operating costs associated with implementation of the offshore emissions reduction portfolio.

Legislative Implications

- 51 There are no legislative implications from the decisions in this paper.

Impact Analysis*Regulatory Impact Statement*

- 52 This paper contains no regulatory proposals, hence Cabinet's impact analysis requirements do not apply.

Climate Implications of Policy Assessment

- 53 This paper contains no regulatory proposals, hence a Climate Implications of Policy Assessment is not required.

Population Implications

- 54 This paper contains no policy proposals, and hence there are no immediate impacts on population groups.

Human Rights

- 55 This paper contains no policy proposals, and hence it has no impacts on human rights or interactions with New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Consultation

- 56 The following agencies provided feedback on this paper: the Treasury, the Ministry for Primary Industries, and the Ministry of Foreign Affairs and Trade.

Communications

- 57 The communications approach to discussing offshore mitigation will align with, support, and amplify any communications related to the NDC strategy.
- 58 Any developments relating to offshore mitigation will be of particular interest to Māori, including Māori foresters and landowners, and NZ ETS participants and related stakeholders. Communication with Treaty partners will be informed by a Treaty analysis from the Ministry for the Environment's internal advisory team.

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Proactive Release

- 59** Parts of this paper are recommended for proactive release at the same time any public announcements are made. Some parts may impact negotiations and should be withheld.

Recommendations

The Minister of Climate Change recommends that the Committee:

- 1 **Note** that this paper responds to Cabinet's invitation to the Minister of Climate Change to report back to Cabinet in December 2022, with a further update on policy matters to progress our efforts for accessing offshore mitigation, with a view to meeting NDC1.
- 2 **Note** that I expect to return to Cabinet in the first half of 2023 with proposals on:
 - 2.1 Objectives for international cooperation
 - 2.2 Types of international cooperation available
 - 2.3 Criteria that the portfolio must meet to achieve the objectives
 - 2.4 Funding arrangements and
 - 2.5 Functions and institutional arrangements.
- 3 **Note** that the Treasury and MfE will provide a public report on estimates of the fiscal costs of meeting NDC 1 in early 2023 and these estimates will address the direct costs of purchasing offshore mitigation but will not include the costs for institutional arrangements such as resourcing for project development or government-government engagement with potential partner countries.
- 4 **Note** that I expect to report back to Cabinet in the first half of 2023 with a proposed strategy to achieve NDC 1 and that the Emissions Reduction Plan and the International Emissions Reduction Plan will implement the strategy.

Authorised for lodgement

Hon James Shaw

Minister of Climate Change

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Appendix 1: Potential types of international cooperation

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Source	Description/examples
Bilateral cooperation to develop new/novel types of projects	s 9(2)(j) [Redacted]
Long-term large-scale partnership to accelerate action beyond host's NDC	The "Climate Teams" model envisages up-front commitment by a buying country to fund (on delivery) additional actions that deliver ERs beyond those achievable by the host alone for its own NDC. Up-front commitment gives the host country the ability to secure finance for the additional investments and enables a focus on system transformation rather than individual projects.
Initiating new projects, implement via existing methodologies and processes	<p>New Zealand does not "reinvent the wheel" but identifies and supports standard project types (in energy, waste etc.) for which methodologies exist or can be readily updated. This could be done through various channels:</p> <ul style="list-style-type: none"> • s 9(2)(j) [Redacted] • s 6(b)(ii) [Redacted] • Bilateral project development with a host country either directly, under the Article 6.4 mechanism, or via other carbon markets
Investment in carbon funds	<p>s 6(b)(ii) [Redacted] Investors (public/private) receive a share of credits generated based on their share of investment in the fund. Investment is committed up front; timing and volume of final emission reductions are uncertain. s 6(b)(ii) [Redacted]</p>

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Source	Description/examples
Purchase of already-generated, already-authorized ERs that meet New Zealand's criteria	Some host countries could potentially develop projects unilaterally (typically with private sector project developers) and make ERs available for sale with "authorisation" for NDC use. These projects could be developed and emission reduction units issued via the UNFCCC Article 6.4 mechanism or through other markets.
Emission Trading Scheme ('ETS') linking (Backstop)	s 6(a) 