

AXEL MICHAELOWA and JOHN O'BRIEN examine **New Zealand's Projects to Reduce Emissions Programme** and outline lessons that can be learned from it

The lessons to be learned

Most countries hosting Joint Implementation (JI) and Clean Development Mechanism (CDM) projects have followed a bottom-up strategy for project development. While some CDM hosts, such as China and India, have complained about the low prices for certified emission reductions (CERs) on the market, no CDM host country has tried to use the domestic approval procedure strategically. The unlikely pioneer in that respect is New Zealand, a country which is sometimes perceived as a net importer of Kyoto credits, but where the government, due to its long position on forestry carbon sinks, is confident it will generate a small Kyoto surplus.

The New Zealand government's Projects to Reduce Emissions Programme (Prep) is a top-down approach, which is essentially a domestic tendering procedure for greenhouse gas (GHG) emission reduction projects where the winners are awarded emission reduction units (ERUs) and/or Assigned Amount Units (AAUs). The programme has been in operation since late 2003 and has generated interesting insights for other countries that might want to follow a similar path.

The New Zealand government has been looking at a wide range of climate policy instruments such as a carbon tax, voluntary agreements, support of mitigation in small and medium-size enterprises and a methane emission tax for agriculture.¹ In April 2003, it started the first Prep domestic tender process.² The rationale behind the mechanism was to create a price incentive for emission reductions prior to the introduction of a carbon tax on fossil fuel use in New Zealand in July 2007, which would be sustained throughout the Kyoto Protocol's first commitment period (2008–12).

In addition, projects from industry sectors not covered by the tax or voluntary agreements could generate additional emission reductions, which would increase the projected size of New Zealand's carbon credits surplus under Kyoto – estimated at 2 million to 3 million tonnes of carbon dioxide equivalent (Mt CO₂e) per year from 2008 to 2012. This would only happen if some of the reductions achieved by these projects give rise to the issuance of ERUs/AAUs.

The goal of the programme is to encourage additional emission reduction projects to take place in New Zealand that would not have happened in a business-as-usual situation. Companies selected as part of the tender process are awarded contracts with the government. These contracts guarantee that the companies will receive ERUs and/or AAUs should they

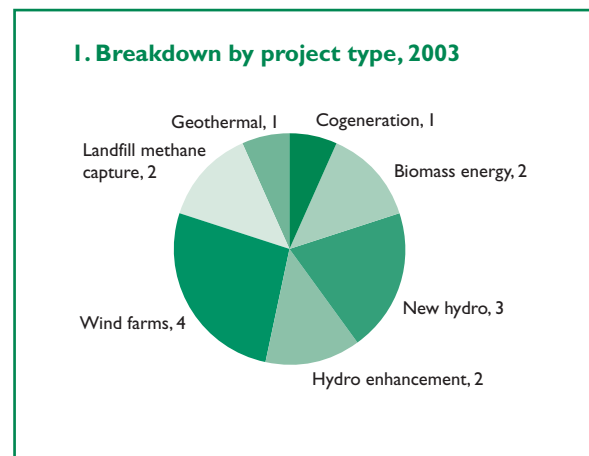
qualify as JI projects. The award of carbon credits takes place in January each year upon the acceptance by the government of the projects' verifiers reports.

These projects are, strictly speaking, not JI projects as there is no international investment component at the time of the awarding of the carbon units. However, the government takes the position that this should not be an issue as it expects the country to satisfy all the eligibility requirements to become a Track 1 JI country. Under the terms of the Kyoto Protocol, countries covered by Track 1 JI will not need the involvement of the JI supervisory committee and accredited independent entities in the project approval process.

Minimum reduction

Projects in the New Zealand programme can cover any of the six GHGs listed in the Kyoto Protocol, but have to reduce at least 10,000 tonnes of CO₂e during the Kyoto commitment period and prove their additionality. Projects that are covered under voluntary agreements and forestry and agricultural sinks are not eligible, as the former would lead to double counting and the latter are deemed to belong to the government. The tender is open to any company, even if it is not based in New Zealand, as long as the project activities are carried out in the country. The main decision criterion of the government is the ratio between the reductions achieved and ERUs/AAUs issued. In the first round, all the projects bid in at a ratio of one tonne of CO₂e reduced for one Kyoto unit. In the second round the average was one tonne of CO₂e reduced for 0.8 Kyoto units. At face value, the government thus far has achieved its aim of generating surplus reductions.

A risk assessment of the project proposals is made by the



¹ Frazer, Stuart (2003): A New Zealand update, in: AETF Review, December-January, p4–6
² Beck, Tony (2004): Tradable permits from NZ projects, in: AETF Review, August–September, p6–9
³ Frazer, Stuart; Lindstrom Frazer, Kerstin; Kessels, John (2004): The New Zealand (JI) Projects Mechanism, ECN, Petten
 3 New Zealand Climate Change Office (2005): Table of successful projects from the 2003 Projects to Reduce Emissions tender round, www.climatechange.govt.nz/policy-initiatives/projects/table-successful-projects.html

government and independent experts are also asked to review each proposal. The additionality test is a direct investment test, that is to say, checking whether the project would have happened a under business-as-usual scenario.

So far, 10 million ERUs/AAUs have been tendered – 4 million in the first round and 6 million in the second round in late 2004. The first round generated 46 bids for more than 45 million ERUs/AAUs of which 15 were eventually chosen. The second round generated 51 bids of which 24 were retained. The breakdown of projects from the first round is shown in Figures 1 and 2³.

The results of the second round have not yet been published in detail.

While the first round focused on electricity generation projects and applied security of power supply criteria, the second round looks only at the reductions achieved in the Kyoto commitment period. Selection criteria related to security of energy supply – which could be interpreted as being contradictory to Kyoto Protocol objectives – have now been dropped.

There are several advantages for countries if they follow the New Zealand approach. These include:

- The fact that the New Zealand projects selected in the tender already have the equivalent of a letter of approval from the government guaranteeing them allocation of Kyoto units is attractive to buyers;
- Selected companies in the tender programme are likely to put a lot more effort into monetising their potential Kyoto units in New Zealand than in countries where the full JI documentation – Project Design Documents, baseline study, monitoring plan, validation etc – is required before the host government can issue a letter of approval;
- Due to the ratio of ERUs to reductions being less than one, the size of the New Zealand AAU surplus under Kyoto is likely to be increased, but only if truly “additional” projects are selected for awarding of units.

Less rigour

However, the additionality test applied by the New Zealand government is not of the same rigour as the comparable international process for CDM validation, registration and approval. Information submitted by companies as part of the tender application process is equivalent to the information which would be included in a Project Idea Note for a CDM or JI project.

One risk therefore, is that the eligibility requirements of the New Zealand government for determining that the project has the potential to qualify as a JI project do not match the eligibility requirements of other countries. A major part of the additionality ‘test’ used in Prep involves a letter signed by the company head stating that it would not implement the project in

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the absence of additional value from carbon credits.

There is the risk, therefore, albeit small, that the government is selecting some projects which are in fact business-as-usual and that by awarding them Kyoto credits the country’s estimated surplus will be reduced. It would be a major embarrassment to the New Zealand government if in, say, two years’ time, it was revealed that the country was no longer on track to meet its Kyoto targets, partly as a result of awarding Kyoto carbon credits to projects that in actual fact are not additional. The estimated 2–3Mt/year surplus is not a large amount and so there should be some contingency for possible mistakes.

Another possible problem is that several projects in New Zealand have been awarded potential ERUs and AAUs, although even with the additional value from credit sales they are unlikely to be commercially viable or even to take place. This is the case for several small-scale renewable energy projects with high costs.

In addition, many of the companies awarded ERUs and AAUs have annual emission reductions of less than 15,000 tonnes CO₂e a year. These projects may be difficult to monetise given high transaction costs in developing JI projects and the fact that buyers of ERUs are seeking larger volumes, with many stressing a preference for a minimum volume of 50,000 ERUs/year.

Finally, the New Zealand government is considering a policy that seeks a direct linkage with the EU Emissions Trading Scheme (ETS). Given the absence of a domestic ETS in New Zealand this goal may be difficult to achieve. However, should it occur, the rationale behind the Prep scheme will be called into question as JI is not allowed in the five industry sectors covered by the EU Emissions Trading Scheme and thus Prep projects in such industries would not be entitled to get ERUs from 2008.

Conclusions

New Zealand is the first host country to have set up a JI tender. One measure of the success of the programme is in the number of new emission reduction projects under the programme which are able to monetise their Kyoto units. As of early 2005, an encouraging sign is that the Dutch ERUPT programme short-listed five New Zealand projects for possible carbon contracting and the Austrian CDM/JI programme short-listed two projects.

In the case of the Dutch programme, the number of short-listed projects exceeds the number of projects from any other single country expected to be a major JI supplier, such as Russia, Ukraine, Poland or Romania. Several European government buyers and Japanese corporates are clearly interested in New Zealand’s emission reductions projects, but whether more will follow remains to be seen. The weak flank of the tender is the additionality test, but the ratio of ERUs issued to claimed reductions allows for 20% of non-additional projects. **CF**

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