

The Chair  
**CABINET POLICY COMMITTEE**

**CLIMATE CHANGE: ADMINISTRATIVE ARRANGEMENTS FOR THE PROJECTS  
MECHANISM**

**Purpose**

1 This paper proposes the administrative arrangement for the Projects mechanism.

**Background**

2 A key component of the Government's climate change policy is a Projects mechanism to incentivise emission reductions. In April 2002 Cabinet agreed that the mechanism would include additionality criteria, and that a contestable approach would be used for selecting proposals where feasible (CAB Min (02) 13/10 refers). The objective of the mechanism is to incentivise actions that will reduce the cost to the Crown of greenhouse gas emissions during the first commitment period of the Kyoto Protocol (2008-2012).

3 In October 2002 Cabinet directed officials to report to POL by 30 November 2002 on the institutional arrangements for the Projects mechanism (CAB Min (02) 26/18 refers). The same decision also included a direction for officials to report to POL by 28 February 2003 on the details of Projects policy, including a process for Projects and any necessary legislation required.

4 The Government has not yet decided on the timing of the initial or exploratory Projects round. The institutional issues considered in this paper will enable the exploratory round to occur in the 2003/2004 year. This timetable will be challenging and requires the operational and administrative framework to be set up during April 2003 for the exploratory round to promptly proceed. Officials consider that the exploratory round should include a focus on discovering the extent, nature, and cost of Projects opportunities and guide future budget bids for subsequent rounds.

5 The Projects mechanism is one of the key components of the Government's climate change policy package. Its successful implementation and the securing of sustainable levels of funding will be critical to New Zealand meeting its policy goal of achieving significant emissions reductions below business-as-usual during the first commitment period (2008-2012).

## **Requirements for a robust Projects mechanism**

6 To ensure that the Crown contribution is allocated to ensure maximum additional emission abatement for the level of investment, the process and institutional arrangements used must:

- Ensure clear accountability for decisions;
- Ensure that all proposals are assessed equitably on their merits;
- Be transparent;
- Ensure confidentiality of commercially sensitive information;
- Minimise administrative costs; and
- Ensure effective integration and maximise synergies with the Negotiated Greenhouse Agreements (NGAs) mechanism and other climate change programmes.

## **Key elements of operating a Projects mechanism**

7 Key tasks for administering the Projects mechanism will be to:

- Request receive and assess proposals;
- Recommend and approve funding for successful proposals;
- Negotiate project agreements;
- Manage agreements, including their monitoring and verification;
- Administer and monitor the financial incentives; and
- Monitor and report on overall outcomes.

## **Requirements for the Projects agency**

8 The key tasks listed above mean that the implementation of the Projects mechanism will require access to a broad mix of skills. These include the core administrative capability for contract and project management; accounting and technical knowledge for financial and technical assessment of bids; and knowledge of specific industries to assist in judging matters such as investment costs and benchmark rates of return. The skills outlined above are spread around departments and some, in particular financial analysis and technical assessments of particular technologies, primarily reside outside government. There are strong overlaps with the NGA mechanism, in particular relating to monitoring, reporting and common skill requirements.

9 Running a contestable process necessarily implies a high level of activity during the submission and assessment periods. A single agency cannot be expected to meet these demands with just its dedicated Projects staff. Temporary assistance will therefore be required from other government agencies and the private sector. This outside assistance will be funded as required from within Climate Change Office<sup>1</sup> baselines. However there is a core capability requirement for the implementing agency, e.g. in managing the process and negotiating and managing contracts, to ensure the efficient operation of the mechanism.

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<sup>1</sup> Throughout this paper we have used the term “Climate Change Office” to reflect the renaming of the Climate Change Project that is recommended in the Cabinet paper “*Institutional Arrangements for the Climate Change Project*”.

10 The Projects mechanism will need a single responsible government agency for accountability and ease of management. It also requires robust administrative systems capable of dealing with a potentially large number of individually complex contractual relationships. The expenditure of potentially significant funds also suggests a need for Ministerial oversight.

### **Options considered**

11 The options include:

- The Climate Change Office, with its core capabilities built up as required and supplemented by substantial input from other agencies. A large proportion of this input would come from EECA; or
- Implementation wholly or largely delegated to EECA, with policy direction from the Climate Change Office. A high level of interaction with the Climate Change Office and other departments would be important to ensure the ongoing development of the mechanism; or
- Another core Government agency (separate from the Climate Change Office) with the relevant capabilities.

### **Discussion of options**

12 The Climate Change Office option offers a greater focus on climate change objectives (in particular cost-effective abatement), closer links to climate policy development, and would achieve potential efficiencies because of a high degree of commonality with NGAs. This option will still require significant reliance on outside (departmental and private sector) support, in particular from EECA.

13 EECA has energy expertise and several years experience in designing and implementing contestable mechanisms for the Government involving grants and loans, including for other Departments such as a \$1m fund administered on behalf of the Ministry of Social Policy. The EECA option offers a greater technical resource in the host agency. They would however require strong policy direction from the Climate Change Office to keep the focus on climate change objectives. There is also a risk of creating perceptions that energy-related proposals might be favoured over say waste or agriculture proposals and which would need to be addressed through the criteria, design and transparency of the process.

14 The other department option is potentially less attractive because while administrative capabilities are available, they have generally less specialist climate change-related expertise and climate change is not a core priority.

15 Overall it is considered that while the Climate Change Office option may involve a greater level of interaction between agencies, it carries less policy risk with respect to integration of the whole of government climate change policies. Potentially it also allows the synergies between climate change programmes to be realised (especially with NGAs) and administrative duplication avoided. This leads to the conclusion that accountability must reside with the Climate Change Office, but that the Office could contract out the implementation of (all or parts of) the mechanism to other government agencies including EECA.

## **Financial implications**

16 Funding will be required for the Projects incentive, and may also be required to support the operational costs of the Projects mechanism.

17 The Projects mechanism has been identified as a core aspect of the Government's climate change response. A preliminary estimate of the cost is approximately \$20 million for the first year possibly rising up to \$50 million in out-years. A decision on the level and type of funding for the initial round will need to be made in time for the 2003 Budget.

18 There are several means of funding this mechanism. They include:

- funding through direct Budget appropriations i.e. pre-2008 from the consolidated fund and post-2008 from recycled carbon charge revenue; or
- funding provided from the sale of emission units (in particular forward sales prior to 2008); or
- by provision of promissory notes to provide emission units in 2008-2012 linked to Project outcomes which are in effect a financial instrument of realisable value; or
- a combination of the above.

19 Tentative enquiries have been received from governments and other entities concerning the possible forward purchase of New Zealand emission units. Officials are considering the issues related to management of emission units, including sale of units, before reporting back as part of the 2003 Budget process.

20 Funding for policy development work in 2002/2003 was approved in October 2002 [POL Min (02) 15/7 refers]. Out-year funding will be sought in the 2003 Budget. Out-year funding will be informed by further work on the design and objectives of the initial Project round, and may be further assisted by seeking preliminary expressions of interest for Projects.

21 The operation and monitoring of the Projects mechanism is tentatively expected to require two to three full-time equivalent staff. These additional staff may be split between the Climate Change Office and EECA. Some assistance during assessment will also need to be contracted, from departments or consultants. These costs will be included in the Climate Change Office 2003/2004 Budget bid, separately from the Projects incentive bid.

## **Consultation**

22 The following departments have been consulted in the development of this paper: the State Services Commission, Inland Revenue Department, the Energy Efficiency and Conservation Authority, Te Puni Kokiri, the Ministry of Research, Science and Technology, the Ministry of Economic Development, the Ministry for the Environment, the Treasury, and the Ministry of Transport.

## **Treaty of Waitangi Implications**

23 There are no Treaty of Waitangi implications arising from this paper.

## **Legislative Implications**

24 There are no legislative implications.

## **Recommendations**

It is recommended that the Committee:

1. **agree** that the responsible agency for Projects be the Climate Change Office, but with a close working relationship with EECA;
2. **agree** that the first contestable Projects round will be held during the 2003/2004 year;
3. **note** that a Budget bid for the initial round will be prepared; and
4. **note** that the detail of the Projects mechanism (including the criteria that proposals will be assessed against in the initial Projects round) will be presented for consideration by POL by 28 February 2003.

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