

'Moderated' NZ ETS: Potential Policy Packages

Key Considerations

Need to take action now:

- Fiscal and economic cost generated by Kyoto commitment (and expected post 2012 agreement). How best to meet that cost?
- Net Position surplus does not translate into fiscal surplus. E.g. post 1989 foresters can opt to receive allocation of units.
- Greatest fiscal risk arises from deforestation if no constraint imposed under ETS.

Key theme in STR discussion on 15/6 - implement ETS "low and early":

- 'Moderated' ETS within fiscal constraints.
- Entry of Stationary Energy and Industrial Processes (SEIP) and Liquid Fossil Fuels (LFFs) on July 2010.
- Low starting price.

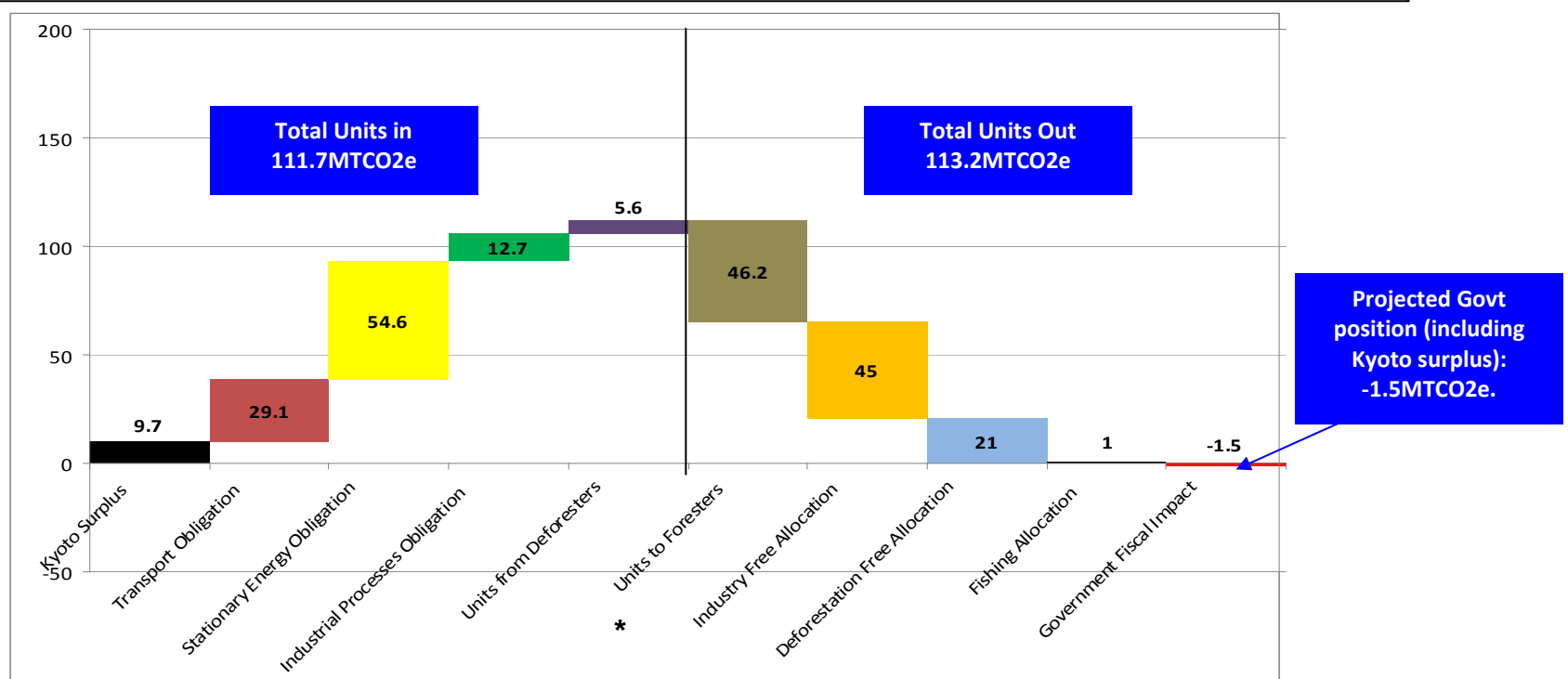
National Manifesto Commitments

National committed to:

- Amend ETS to: balance economic and environmental interests; achieve fiscal neutrality; align with Australia; improve efficiency; avoid discrimination against SMEs; flexibility to respond to international negotiations; provide higher allocation to fishing.
- Adopt '50% by 2050 target.

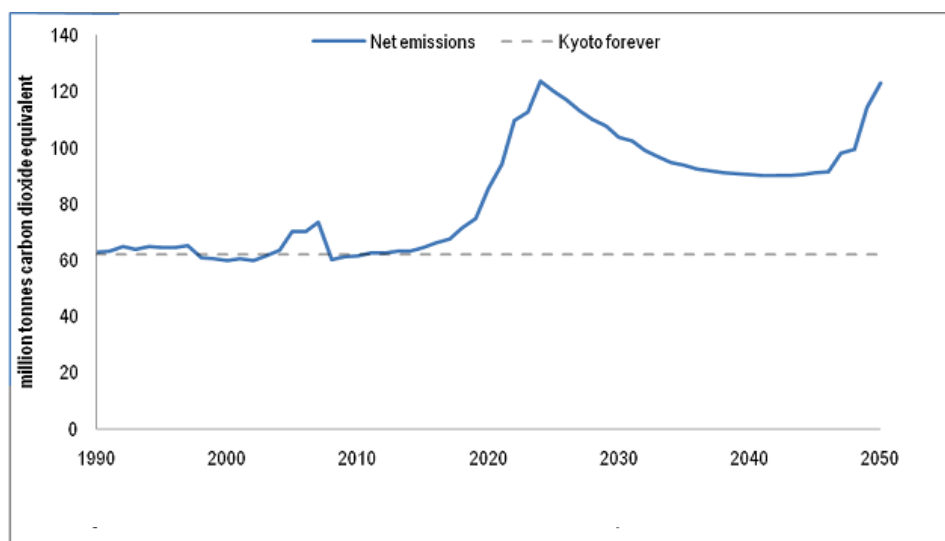
Net Position and Fiscal Position (Current ETS Scheme)

Fiscal rules = any policy change which has positive or negative fiscal impacts must be charged.
Fiscal position already takes into account net position as well as unit inflows and unit outflows.



* This is based on 50% of post 1989 forests opting in and receiving units. MAF estimates that 692,583 units have been issued so far and there is uncertainty about how many more forest owners will opt in. This is a two-edged sword: smaller number of opt-ins would deliver fiscal savings in the short-term, it creates a greater fiscal liability for government in future (since government retains responsibility for any future harvest).

New Zealand: Long Term Emissions Challenge



Current ETS Compared with Proposed Australian CPRS

	Current NZ ETS	Proposed Australian CPRS*
Sectoral Entry	• Jan 2008: Forestry. • Jan 2010: Stationary Energy and Industrial Processes • Jan 2011: Liquid Fossil Fuels • Jan 2013: Agriculture and Waste.	• July 2011: Stationary energy, transport, industrial processes and waste • July 2015: Agriculture potentially enters
Fixed Price	None	• Jul 2011 – Jun 2012: Fixed Price at AUS\$10.
Price Cap	None	• Jul 2012 – Jun 2016: Price cap at AUS\$40 rising at 5% real/ yr.

* CPRS still subject to significant uncertainty.

Key Options

1. **Amend ETS with Minister for Climate Change Issue's Preferred Package.** Fiscal cost set out next page.
2. **Do Nothing.** Repeal ETS. Taxpayer funds Kyoto and expected post 2012 liability. **Likely fiscal cost uncertain, could = over \$2bn CP1-CP2.**
3. **Minimal changes.** Leave ETS as is but delay SEIP to January 2011 (2010 timetable not possible). **Fiscal cost = \$200m total.**

POLICY CHOICES

N.B. All cost estimates subject to review and underlying policy assumptions.

\$12 Fixed Price
July 2010 – June 2012

- ETS operates as a fixed charge for 2 years until full trading (possibly followed by price cap).
- Additional assistance provided to most at risk firms.
- Ban on exports needed (particular impact on forestry).
- Lowers initial impacts on all participants. Strong price certainty for 2 years.
- Risk of accelerating deforestation from pre-1990 forests unless further measures to limit deforestation introduced in combination.
- **During fixed price \$12 units issued to foresters, not full Kyoto units (2/5 of post-89 forestry units, all pre-1990 allocation). Reduced compensation for pre-1990 reduced land value. Reduced incentives for new planting. Administratively complex. Assumes meets full value of Treaty settlements.**
- Fiscal savings if issue \$12 units to foresters. Long-term economic costs (from higher emissions) small for 2 years.

Total cost (relative to status quo)	Total cost of fixed price	Saving from \$12 units to foresters	Potential deforestation (per annum)	Petrol price increase	Electricity price increase (retail)
\$110m	\$480m	+\$440m	Over \$35m	3c/ litre (1.8%)	0.8c/ KWh (3.6%)

Price cap at or just above international price
July 2010 – June 2016

- Full trading with price cap (various options for exact level).
- Ban on exports needed (in case international price rises above price cap).
- Low fiscal costs (assuming remains above international price).
- Significant price certainty & protection from price volatility for 5 years.

Fiscal and economic costs likely to be low, assuming price cap remains at or above international price (moderate risk before 2016).

Total saving (per annum)	Potential deforestation	Petrol price increase	Electricity price increase (retail)
Poss. +80m but risks	Poss. 0 but risks	6.2c / litre (3.6%)	1.7c /KWh (7.6%)

ALTERNATIVE? \$5 fixed price for 1-2 years. Bring forward SEIP and LFFs to January (or April) 2010.

- ETS operates as a fixed charge for 1-2 years until full trading (possibly followed by price cap).
- No Free Allocation Needed (equivalent to 80% assistance rate – harder for some parties). Can bring forward SEIP and LFFs to January (or April) 2010.
- Provides more time to consult on/ implement allocation decisions.
- Ban on exports needed (particular impact on forestry).
- Very low initial impacts on most participants.
- Strong price certainty for 2 years.
- Risk of accelerating deforestation from pre-1990 forests unless further measures introduced to limit deforestation in combination.
- **During fixed price \$5 units issued to foresters, not full Kyoto units (2/5 of post 89 forestry units, all of pre-1990 allocation). Reduced compensation for pre-1990 reduced land value. Reduced incentives for new planting. Administratively complex. Assumes meets full value of Treaty settlements.**
- Fiscal savings if issue \$5 units to foresters. Long-term economic costs (from higher emissions) likely to be small for 2 years fixed price.

Total cost (relative to status quo)	Total cost of fixed price	Saving from \$5 units to foresters	Potential deforestation (per annum)	Petrol price increase	Electricity price increase (retail)
\$415m	\$365m	+550m	Depends on other measures. If no other measures, could be \$300m	1.2c/ litre (0.7%)	0.33c/ KWh (1.5%)

Australian Allocation Model

- Uncapped intensity-based allocation for Emissions Intensive Trade Exposed (EITE) industries (from 2013).
- Slower, more gradual phase-out subject to 5-yearly review.
- For industry, if adopt Australian thresholds, rates of assistance and phase-out rate: fiscal saving in range of \$100m per annum in 2011, rising to fiscal cost in range of \$100m per annum by 2020.
- For agriculture: fiscal cost in range of \$100m per annum from 2013.
- Long term economic costs from increased emissions in sectors receiving intensity based allocation over a longer period.
- Note some resistance to Australian model (thresholds, definitions of activities etc.) likely (costs and time required to implement may well increase if hybrid model adopted).

Offsetting for Pre 1990 Forests

- Implement offsetting for pre-1990 forests now in anticipation of international rule change after 2012.
- Cancel free allocation for pre-1990 forests.
- Remove all deforestation exemptions (N.B. will impose costs on small forest owners).

Fiscal cost:

- **[withheld]**

Provide voluntary ‘averaging’ for post 1989 forests

Decisions on rules will determine fiscal cost:

- Can design rules to meet any overall fiscal budget.
- Averaging removes long term uncertainty for new forest planters. Likely to result in more planting.
- Possible to design rules for potential neutral fiscal cost over commitment periods, but may reduce uptake incentives.
- Reduced incentives for participants to take account of carbon prices when harvesting.
- Note: can be achieved without amendment to the ETS.

Minister for Climate Change Issues - Preferred Package

Policy Change	Fiscal Cost (-) / Fiscal Saving (+)
Fixed price of \$12 July 2010 – June 2012	-\$110m total (2011-12). Includes potential deforestation. Includes reduced value in units being issued to foresters and cash compensation for Treaty settlements (N.B. also implicitly includes timing changes – note that bringing LFF and SEIP to 1 July 2010 start date would save the Crown \$80m).
Industry – adopt Australian allocation model, thresholds and phase out rate.	+ \$100m per annum (2011), rising to - \$100 per annum (2020).
Fisheries – 90% allocation over 3 years	Potentially \$0 fiscal cost
[withheld]	[withheld]
Introduce voluntary ‘averaging’ for post 1989 forests.	[withheld]
Total CP1	[withheld]
Total CP2	[withheld]