Climate Change Policy Options

What are we trying to achieve?

- Climate Change is a real issue. New Zealand has an economic imperative to manage emissions. Price-based mechanism must be central to our efforts.
- Special Select Committee likely to support Emissions Trading Scheme (ETS) as preferred price-based mechanism.
- ETS legislation passed under previous government already in force. Stationary Energy and Industrial Processes (SEIP) due to enter on 1 January 2010. Allocation plan required for pre-1990 Forestry by June 2009. **Not possible to meet these timetables. Need to change them as a matter of urgency.**
- In addition, need to create a 'moderated' ETS, e.g., to:
  - Reduce competitiveness impacts / provide greater certainty for economic growth.
  - Create greater options for land-use flexibility.
  - Improve incentives for new forest planting.
  - Provide a smoother transition for participants / protect against price volatility in early years.
  - Be affordable with current fiscal constraints.
  - Recognise uncertainty about post-2012 international framework.
  - Maximise harmonisation with Australian Carbon Pollution Reduction Scheme (CPRS).
  - Meet National Party Manifesto commitments.

PROCESS FORWARD AS PER CABINET DISCUSSION 8 JUNE

- Introduce Bill under urgency to deal only with forestry timing issues *(Bill already drafted)*.

AND

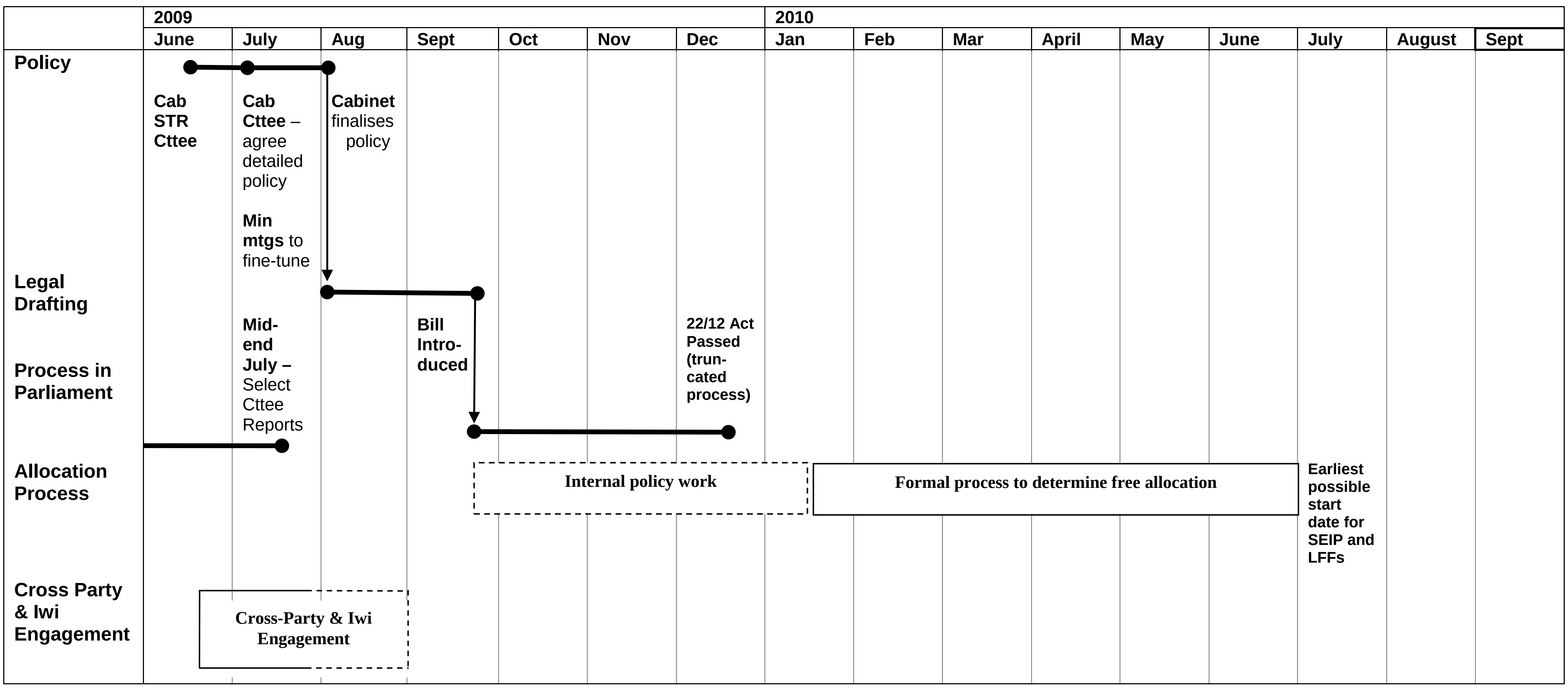
- Complete design of NZ ETS with full amendment Bill introduced in September and passed through truncated Select Committee process to pass into law by 22 December. Bill would include setting entry date for Stationary Energy and Industrial Processes and Liquid Fossil Fuels at 1 July 2010.

KEY RISKS:

- If full amendment Bill not passed by December 2009, Stationary Energy and Industrial Processes starts without allocation plan on January 2010.
- To introduce Bill in late September will require policy decisions by end July / early August.
- **[Withheld]**.
- Securing majority support in Parliament.

Decision Making Process Going Forward

Ministerial process needed to arrive at final policy decisions on package of amendments by late July / early August.



'MODERATED' ETS: POTENTIAL AMENDMENTS

Fixed Price/ Allocation

- Option of a fixed price for 2 years (July 2010 – June 2012) at NZ$12 approx (significant fiscal cost – same as Australian CPRS in July 2011 – June 2012)
- Option of price cap for 5 years until 2016 at NZ$50 initially, rising 5% real per annum (potentially low fiscal cost – same as Australian CPRS).
- Intensity-based allocation for Emissions Intensive Trade Exposed (EITE) industries and Agriculture (potentially medium-significant fiscal cost). Slow/ gradual phase-out subject to 5-yearly review.

Introduction of fixed price or price cap means NZU exports would have to be banned (impacts most on forestry).

Direct linking (mutual exchange of units) with CPRS would require same price controls as CPRS and ban on import and surrender of AAUs.

Shape/ passage of CPRS subject to political uncertainty.

Retail Price Increases from $12 / CO2e Carbon Price

	Price increase	% increase
Petrol (GST inclusive)	3.0 c / litre	1.7%
Diesel (GST inclusive)	3.2 c / litre	2.5%
Electricity	0.8 c / KWh	4.0%
Gas	$0.7 / GJ	1.6%
Coal	$0.7 / 20kg bag	8.0%

N.B. % increase for wholesale prices will be higher

Targets

- Put '50 by 2050' target in legislation.

Forestry

- Increase flexibility in the forestry sector through offsetting regime for pre 1990 forests and remove associated free allocation **[withheld]**.
- Provide option of averaging for post-1989 forestry (Fiscal cost depend on level of 'average carbon stocks'. If at similar level to Australia fiscal costs approx $80m per annum from 2022. Possible to design rules for neutral fiscal cost).

Other Issues

- Agriculture: provide flexibility to move back to farm level in longer term once confirmed choice of processor as initial point of obligation.
- Fisheries: allocate to fisheries on same basis/ for same length of time as industry and agriculture (approx fiscal costs of $10-$13m per annum by 2020).
- More minor and technical amendments to improve workability.

Timing Options

- Delay SEIP 6 months to July 2010 (fiscal cost $100m).
- Delay SEIP by 6 months and also bring forward Liquid Fossil Fuels by 6 months to July 2010 (fiscal benefit $80m).
- Note every year Agriculture delayed fiscal cost $150m.

How Much Could We Do Under Current Act?

Limited fallback options (some details may be complicated to implement):

- Limited shift to intensity-based allocation methodology. Cap on total quantity of allocation (90% of 2005 emissions for Agriculture/ Industry, 50% for Fisheries) and existing phase-out rates would remain (i.e. allocation per unit output would fall with growth).
- Confirm processor as initial point of obligation for agriculture but without flexibility to move back to farm level at later date.
- Could do voluntary 'averaging' regime for post 1989 forest but not pre 1990 forest 'offsetting'.
- Able to limit export/ import of units and might be able to operate a 'reserve price mechanism' (likely to be complex / messy solution).

Consumer assistance measures:

- NZ ETS will result in higher energy and transport fuel prices. Options include use of tax reductions, benefits, further grants for energy efficiency measures etc.

Key Considerations for ETS Amendment Options

Key benefits:

- Protects competitiveness of most at risk firms for longer: intensity-based allocation.
- Certainty: esp. $50 temporary price cap.
- Land use flexibility: forestry options.

Key risks:

- Fiscal and economic costs: esp. delay in entry of agriculture, $12 fixed price.
- Fiscal uncertainty: esp. forestry options, intensity-based allocation.
- Administrative complexity: forestry options, $12 fixed price, intensity-based allocation (especially if deviate significantly from Australian thresholds/ activity definitions).

Key Choices for Amendments to Legislation

- What price level? Low fixed price (high fiscal cost) or higher price cap to manage price volatility (low fiscal cost)?
- Intensity based allocation? For which sectors? Using what thresholds? Total quantity capped or uncapped? What phase-out rate?
- Offsetting: now (risk of high fiscal/ economic cost if not agreed internationally) or after new international rules agreed?

Other Climate Change Issues Coming Up

International negotiations:

- Briefing for Ministerial group on public meetings around options for 2020 targets in July.
- Decisions on New Zealand position needed by August (and pre-December) on 2020 targets and conditions, forestry rules (and agriculture?).

Domestic policy:

- Developing our story around govt's broader climate change package: moderated ETS plus other measures. E.g.:
  - $323 million New Zealand home insulation fund.
  - $36 million biodiesel grants programme.
  - Electric vehicles exemption from road user charges.
  - RMA reforms streamlining renewable energy consenting process.
  - National Policy Statement for Renewable Electricity Generation.
  - $5m per annum for a Centre for Agricultural Greenhouse Gas Research.
  - Revised Energy Strategy 20 July.