



## Approval to draft annual update to price of carbon and synthetic greenhouse gas levy rates

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Security Level	In-Confidence	MfE Priority:	Not Urgent

	<b>Actions sought:</b>	<b>Response by:</b>
Hon James SHAW, Minister for Climate Change	Approve drafting instructions	19 July

Actions for Minister's Office Staff	<b>Return</b> the signed report to MfE.
Number of appendices and attachments	Nil

### Key contacts

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# Approval to draft annual update to price of carbon and synthetic greenhouse gas levy rates

## Key messages

1. This briefing seeks your agreement to issue drafting instructions for amendments to the Climate Change (Synthetic Greenhouse Gas Levies) Regulations 2013 (the SGG regulations). The amendments will:
  - update the price of carbon in the SGG regulations
  - make corresponding updates to levy rates for imports of goods and motor vehicles that contain synthetic greenhouse gases (SGGs).
2. We recommend the amendment regulations are submitted to the Cabinet Legislation Committee (LEG) in time for its meeting on 23 September 2021. The amendments need to be in force by 1 January 2022 and will apply new levy rates from that date.

## The synthetic greenhouse gas levy

3. The SGG regulations put emissions prices on imported goods that contain SGGs, such as motor vehicles, refrigerators, heat pumps and air conditioning units.
4. Amendments to the SGG regulations will specify:
  - the price of carbon for the 2022 levy year; and
  - the subsequent SGG levy rates for leviable goods and motor vehicles using the new carbon price.
5. Cabinet has previously agreed that these levies are updated each year to align with the average emission unit price for the preceding financial year.
6. This means that you may authorise the drafting of these proposed amendments to the SGG regulations without consideration by Cabinet. No new policy decisions are required. The levy rate changes use a calculation methodology within the SGG regulations and the changes are routine, minor, and technical.

## Carbon price calculation

7. The carbon price for the 2022 year is calculated from a weekly average of secondary market New Zealand Unit (NZU) prices for the year of 1 July 2020 to 30 June 2021 as per the methodology set by the SGG regulations. The calculated carbon price for 2022 is \$36.50 (the carbon price for 2021 is \$25.60). The methodology means the calculated carbon price lags both increases and decreases in the secondary market price.
8. The carbon price is also used to determine penalties and cost recovery.

## Recommendations

We recommend that you:

- a. **Note** the calculated price of carbon to be used to update the Climate Change (Synthetic Greenhouse Gas Levies) Regulations 2013 (SGG regulations) for 2022 is \$36.50.
- b. **Agree** to issue drafting instructions to the Parliamentary Counsel Office to amend the SGG regulations to:
  - i. update the carbon price; and
  - ii. update the individual levy rates that apply to imports of goods and motor vehicles that contain synthetic greenhouse gases.
- c. **Note** that these amendments will be taken to the same LEG meeting on 23 September as other amendments to NZ ETS and SGG Levy regulations as part of the annual regulation updates.

Yes/No

## Signature

Lisa Daniell Director - Climate Mitigation	Approved electronically
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Hon James SHAW, Minister of Climate Change	
Date	

## Purpose

1. This briefing seeks your agreement to issue drafting instructions for amendments to the Climate Change (Synthetic Greenhouse Gas Levies) Regulations 2013 (the SGG regulations) to:
  - update the price of carbon used to calculate levy rates; and
  - update the individual levy rates for imports of goods and motor vehicles that contain synthetic greenhouse gases (SGGs).

## Context

2. Importers of goods containing SGGs (such as motor vehicles or refrigerators) are not required to participate in the New Zealand Emissions Trading Scheme (NZ ETS). Instead, these importers are charged levies (the SGG levy) based on the amount and type of SGG in the goods they import, and the price of carbon as set in the SGG regulations.
3. The price of carbon in the SGG regulations is updated every year. The price of carbon is used for various purposes, including:
  - calculating SGG levy rates
  - calculating penalties for ETS participants
  - recovery of costs from ETS participants.
4. SGG levy rates are updated every year to incorporate updates to the price of carbon.
5. The updates proposed in this briefing are procedural in nature and, as with previous years, do not require Cabinet consideration to authorise drafting.

## Analysis and advice

### Price of carbon

6. The price of carbon is set using the methodology prescribed in regulation 9 of the SGG regulations. This is calculated after 30 June each year and is then available to be prescribed in regulation 10 for the following calendar year.
7. The Climate Change Response (Emissions Trading Reform) Amendment Act 2020 implemented a new section 30W to the Climate Change Response Act 2002 (the Act) relating to regulations setting the price of carbon. The transitional measures in clause 15 of Schedule 1AA of the Act allow that any previous regulations prescribing the methodology for specifying the price of carbon apply as though made under Section 30W.
8. Updates to the price of carbon in the SGG regulations can be made under section 30W(1)(b) of the Act. As these regulations are routine and do not require new policy decisions, the Minister responsible for the Act may authorise drafting without reference to Cabinet.
9. Section 236 of the Act imposes a maximum price of carbon for the purpose of calculating levy rates for those years starting before the start of auctions. As auctions

commenced during 2021, this section imposes no maximum price of carbon for calculating levy rates for 2022.

10. Weekly average New Zealand Unit (NZU) prices in the year from 1 July to 30 June are used to calculate the carbon price to apply for the following year. More frequent updates to levy rates are not possible given the time needed for regulatory change and implementation. Less frequent updates would risk levy rates not being an accurate reflection of prevailing NZU prices.
11. The carbon price methodology is specified in the SGG regulations and no further policy decisions are required in relation to this calculation. The current levy rates will continue to apply if the carbon price is not updated.
12. The carbon price for 2022 is calculated as \$36.50. This is an increase of 43 per cent from the 2021 carbon price of \$25.60. Table 1 shows the movement in the price of carbon over time.

**Table 1: Annual carbon prices**

	2014	2015	2016	2017	2018	2019	2020	2021	2022
Price (NZ\$)	1.65	0.64	0.30	9.85	17.67	19.88	24.54	25.60	\$36.50

### SGG levy rates

13. SGG levy rates are prescribed in the schedules of the SGG regulations.
14. Cabinet has previously agreed that these levies are updated each year to align with the average emission unit price for the preceding financial year. This means that you may authorise the drafting of the proposed amendments to the SGG regulations without consideration by Cabinet. No new policy decision is required. The updates to levy rates use a calculation methodology set out within the SGG regulations and are routine, minor and technical.
15. Each item subject to the SGG levy attracts a different levy rate depending on the amount of SGG contained in the item and its global warming potential:
 
$$R = A \times B \times \text{GWP}$$
 Where:
  - R is the levy rate
  - A is the amount of SGG contained in the item in kilograms
  - B is the price of carbon
  - GWP is the global warming potential for the specified SGG in the item.
16. The carbon price affects the levy rates for goods specified in Schedule 2 of the SGG regulations and eight classes of motor vehicles specified in Schedule 1. Table 2 shows a selection of levied goods to illustrate the proposed levy rate changes.

**Table 2: SGG levy on selected goods (excluding GST)**

	2016	2017	2018	2019	2020	2021	2022
Medium sized refrigerator	\$0.02	\$0.94	\$2.11	\$2.84	\$3.51	\$3.66	\$5.22
Medium sized domestic heat pump containing R410a	\$0.47	\$20.59	\$46.16	\$62.32	\$76.93	\$80.26	\$114.43
Private car	\$0.13	\$5.63	\$12.63	\$17.06	\$21.06	\$21.96	\$31.32

### SGG levy revenue

17. Revenue from the SGG levy is paid to a Crown account. Uncertain impacts of COVID-19 on imports complicate our estimates of SGG Levy revenue. Our estimate of the fiscal implications of the proposed increases in SGG levy rates is levy revenue of approximately \$21.1 million in 2021/22. This is based on consistency of import numbers across years. Table 3 shows the change in SGG levy revenue over time.

**Table 3: SGG levy revenue (excluding GST)**

	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
SGG Levy revenue (\$million, including GST)	0.2	2.6	7.2	11.9	11.8	16.7	Estimate: 21.1

### Consultation and collaboration

18. There is no statutory requirement to consult on changes to the levy rates and no consultation has been carried out.

### Risks and mitigations

19. The SGG levy is a small but increasing component of the price of imported goods containing SGGs. Increasing the levy will increase prices of some consumer goods. However, the levy is still a relatively minor part of the total cost of most consumer goods. Additionally, local manufacturers of heating, ventilation and air conditioning equipment who purchase bulk SGGs for their products would be at a competitive disadvantage if the SGG levy is not increased to match the increased price of carbon.

20. If the SGG levy rates are not updated by amendments to the SGG regulations before the end of September 2021, then the levy rates for 2021 will continue to apply for 2022. These will be significantly lower than they should be and undercharge SGG importers. We consider that we have allowed sufficient time for the Parliamentary Counsel Office to draft the amendments in time for presentation to LEG in September, although timing is very tight given other demands on the PCO. Early engagement with PCO on this drafting requirement has occurred. There is no provision for these regulations to come into force earlier than three months after their date of notification in the Gazette.

21. The New Zealand Customs Service is revisiting all tariff codes as part of work to conform to the World Customs Organisation's update of the Harmonised Tariff<sup>1</sup>. The timing of these updates, and possible implications for the SGG regulations remain unclear. The Ministry of Business, Innovation and Employment (MBIE) has responsibility for the Tariff Act. We have been advised that any such update will involve MBIE seeking approval for consequential amendments to other legislation, including the SGG regulations, as required.

## Legal issues

22. Section 30W of the Act requires you to take into account the following matters before making a recommendation to update the carbon price:
- the price of the units used to calculate revenue from the NZ ETS in the Crown annual financial statements in the preceding 12 months; and
  - the price of NZUs sold by auction in the preceding 12 months; and
  - any changes to the operation of the NZ ETS that have affected the price of the units surrendered under that scheme, or that may do so before the end of the next levy year.

### Price of units in Crown annual financial statements

23. In relation to the first requirement, the carbon price in the SGG regulations is not materially different to the Crown Accounts' carbon price used to reflect revenue for 2020/21. The methodology for the Crown Accounts' carbon price draws on the same source data and uses a similar approach to calculation to that prescribed for calculation the price of carbon in the SGG regulations.

### Price of NZUs sold by auction

24. There have now been two auctions. The first auction cleared at \$36.00 and the second at \$41.70. The price of carbon calculated by the methodology in the SGG regulations has arrived at a price between the clearing price of these two auctions.

### Changes to the operation of the NZ ETS affecting the price of surrendered units

25. Changes to the price of units as a result of changes to the operation of the ETS are accounted for with the existing carbon price methodology as it uses NZU market prices. Therefore, changes to the operation of the NZ ETS that have affected the price of surrendered units are taken into account. It is difficult to predict the impact of NZ ETS changes on the price of units to be surrendered in 2022. It is important to note that many participants with surrender obligations will have secured 2022 supply already, at prices used in calculating the update to the price of carbon.

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<sup>1</sup> The Harmonised System nomenclature is a goods classification system used by New Zealand and more than 190 other countries as a basis for their customs tariffs and for the collection of international trade statistics. The World Customs Organisation is responsible for the Harmonised System.

## Financial, regulatory and legislative implications

26. This change will increase the SGG levy rates faced by importers. This will increase revenue to the Crown as discussed earlier (paragraph 17, table 3). This is expected to result in an approximately \$4.4 million increase in revenue to the Crown in the 2021/22 financial year and a further increase for the 2022/23 financial year.

## Next steps

27. We propose to submit the amendment regulations to LEG for its meeting on 23 September 2021.
28. As amendments to the SGG regulations must come into effect no less than three months after the date they are notified in the New Zealand Gazette, this timetable ensures they are able to have effect from 1 January 2022.