Consultation on proposed regulations for the Synthetic Greenhouse Gases (SGG) levy

Purpose of this document

The Minister for Climate Change Issues is seeking feedback on proposed regulations for the synthetic greenhouse gases (SGG) levy. The two areas that are being consulted on are:

- the methodology for setting the carbon price for the SGG levy from 2014 onwards (Part 1)
- an exemption for motor vehicles that are entry certified prior to 1 July 2013 (Part 2).

Other consultation documents cover changes that affect

- updates to NZ ETS allocative baselines and
- updates to NZ ETS operational regulations.

Background

Status quo

The Climate Change (Emissions Trading and Other Matters) Amendment Act 2012 removes the NZ ETS obligation on the importation of hydrofluorocarbons (HFCs) and perfluorocarbons (PFCs) in goods and motor vehicles, and replaces it with a levy linked to the carbon price.

HFCs and PFCs are refrigerants, also known as Synthetic Greenhouse Gases (SGGs), and are contained in air-conditioning units, refrigerators and motor vehicle air-conditioning units. The refrigerants are characterised by very high global warming potentials (GWPs) and are released into the atmosphere as the product is used.

The Synthetic Greenhouse Gas (SGG) levy starts on 1 July 2013.

Problem definition

Part 1 – Carbon price methodology

The Climate Change (Synthetic Greenhouse Gas Levies) Regulations 2013 sets out a transitional methodology for setting the carbon price for the SGG levy. This transitional methodology only covers the period 1 July 2013–31 December 2013. Therefore, a permanent methodology for setting the carbon price for future levy years, starting with the 2014 levy year, needs to be set in regulations.

Part 2 – Exemption for motor vehicles

All vehicles that are registered for on-road use will be required to pay the SGG levy which will come in effect on 1 July 2013. The New Zealand Transport Agency (NZTA) will collect the SGG levy. Prior to a vehicle being registered for on-road use, the vehicle's information is entered into the Motor Vehicle Register. This process is called entry certification. On 1 July 2013, the entry certifiers will be required to enter information about the SGG in each vehicle's air-conditioning unit. This will allow NZTA to know whether or not to charge the SGG levy at registration.

A short-term problem has been identified for when a vehicle is entry certified prior to 1 July 2013 but is not registered until on or after 1 July 2013. During the initial months of the SGG levy, some vehicles will be registered for on-road use, but no information regarding the air-conditioning unit will be available. This will mean it is impractical for NZTA to collect the SGG levy, as the necessary information to charge the levy will not have been collected.

Objectives of the SGG levy

In addressing the problems identified above it is important to ensure the proposed regulations:

- ensure goods and motor vehicles containing SGG face a carbon price that is equivalent, over the long term to those importing SGG in the NZ ETS
- minimise administration and compliance costs of importers of goods and people registering motor vehicles for on-road use.

Assessment criteria

In order to meet the objectives, the following criteria must be met:

Efficiency – adopt and maintain only regulations for which the costs on society are justified by the benefits to society

Effectiveness – regulation should be designed to achieve the desired policy objectives

Transparency and clarity – the regulation-making process should be clear, and regulatory processes and requirements should be as understandable and accessible as practicable

Equity – regulation should be fair and treat those affected equally

Environmental integrity – the environmental integrity of the NZ ETS should be maintained.

These criteria are also in line with the legislative criteria that the Minister for Climate Change Issues must have regard to when making a decision on creating an exemption under the SGG levy.

Part 1 – Carbon price methodology

Proposal

The Climate Change Response Act 2002 sets out the carbon price methodology and calculation of the carbon price for the SGG levy through regulations.

There are two questions that need to be assessed when considering the carbon price methodology:

1. which type of emission unit to use to value the carbon price?
2. which point in time to take the carbon price from the chosen emission unit?

Question one: Which type of emission unit to use to value the carbon price?

The only viable option is to continue the current transitional methodology used by the Crown for valuing a NZU, which is currently the sCER.

This methodology used to arrive at this price, and the principles it is based on, have been agreed between officials from the Ministry for the Environment, Treasury and Audit New Zealand.

This methodology works by averaging the value of the unit used in the Crown's annual financial statements to value the NZU. The methodology is based on the price of eligible units that have an observable market input. In this sense, 'eligible' means the unit is able to be surrendered in the NZ ETS. Observable market input means market data, such as publicly available information about actual events or transactions, was available on the particular emission unit and that information would reliably reflect the assumptions that market participants would use when deciding to buy or sell these units.

Currently, the unit used is a secondary Certified Emission Reduction unit (sCER) which is well-traded and has an observable market price. However, the Government can choose to change to another unit or units, if there is evidence that another unit is a better reflection of the NZU price.

The Point Carbon website publishes a daily spot price at which market participants are buying or selling sCERs.

Question two: Which point in time to take the carbon price from?

Option 1: The first option would be an average of the daily spot price of the chosen emission unit (or units) from the previous financial year. For example, this would mean the carbon price for the 2014 levy year would be an average of the carbon price over the period 1 July 2012 to 30 June 2013.

Option 2: The second option would be to take a shorter average, such as a six-month average. This would mean the carbon price for the 2014 levy year would be an average of the carbon price from 1 January to 30 June 2013.

Option 3: The third option would be to take the spot price of the chosen emission unit on 30 June 2013.

It is important to note for all three options a six-month gap is required between when the price is calculated and the start of the levy year. This is to allow for the regulations to be updated with new levy rates, allow Customs and NZTA to update their systems, and provide businesses with sufficient lead time to prepare for the new rates. Therefore, the carbon price can be taken no later than 30 June on any particular year.

Assessment of options

As the current carbon price methodology is transitional and will not be applicable for future levy years, the option will not be assessed against this status quo. Instead, the option will be assessed by whether or not it will impact positively or negatively on the assessment criteria.

Assessment against evaluation criteria

Question one: Which type of emission unit to use to value the carbon price?

Efficiency – the particular emission unit used for the carbon methodology will not make a significant difference for costs and benefits on society.

Effectiveness – an effective carbon price methodology would use an emission unit that has an observable market price.

The emission unit would be close in price to the price of the emission units used by the SGG sector that remain in the NZ ETS, and used by other NZ ETS participants. This would minimise the potential for competition distortion between those facing the levy (importers of goods and motor vehicles) and those remaining in the NZ ETS (importers of bulk SGG).

A particular challenge in setting a levy price is NZ ETS participants can use a variety of carbon units purchased at different times to meet their NZ ETS obligations. As a result, there will be some divergence between the levy and NZ ETS costs faced by different participants, regardless of the option chosen.

The proposal presented relies on setting a carbon price through choosing an emission unit the Government uses for carbon accounting practices.

Carbon accounting is likely to evolve as accepted standards are established, and will be subject to any government policy decisions that determine which units are eligible for use within the NZ ETS. Currently, the use of sCERs produces an observable market price as the sCER emission unit has many data points for its price and is considered to be part of a liquid market.

Transparency and clarity

The fact that this methodology is being set out in regulations provides transparency and clarity to those affected by the levy.

The proposal presented provides transparency and clarity as the Government publishes the emission unit and emission unit price it uses for valuing the Crown's unit asset in the Annual Financial Statement. The methodology for setting this emission unit and emission unit price is decided by government officials and reviewed by Audit New Zealand, but is not subject to consultation with the public. There is no public consultation required in finalising the Government's financial statements.

Equity

The proposal does have the risk of being unfair for those paying the levy. Inherent to creating the SGG levy was the decision to increase price certainty for the participant. However, this was traded off against the participant losing the flexibility of the market. Therefore, it was accepted the carbon price faced by the participant would need to be as close as possible to what they would have faced in the market. However, it was accepted this could never exactly match, despite the methodology being based on sound accounting practices and observable market inputs.

Environmental integrity

The levy has environmental integrity by placing an added cost on SGG for all sectors. The emission unit used for the carbon methodology will not affect the environmental integrity of the levy.

Question two: Which point in time to take the carbon price from?

Efficiency

The point in time the carbon price is taken from will not make a significant difference to the costs and benefits on society. In the long term, the costs faced by SGG levy payers and the costs faced by other emitters will even out.

Effectiveness

An effective carbon price methodology would use an emission price point that produced a fair representation of market price.

An effective carbon price methodology would use an emission price point that would produce a price close to the price of the emission units used by the SGG sector participants who remain in the NZ ETS. This would minimise the potential for competition distortion between those facing the levy (importers of goods and motor vehicles) and those remaining in the NZ ETS (importers of bulk SGG).

Option one would be the most effective as it takes an average over a long period of time and thus evens out the peak and troughs of the price of any particular emission unit. This would mean it is very likely to produce a fair representation of the market price that is close to the emission unit price faced by those in the NZ ETS.

Option two would be less effective than option one, but more effective than option three. This is because the time period the average is taken over is shorter, meaning the peaks and troughs of the price would be more prominent. It is likely to still produce a reasonably fair market price. However, the risk of divergence in price used by the levy from the price faced by those under the NZ ETS is greater.

Option three would be the least effective of the three options. This is because taking a spot price on any particular day risks using a price that is not representative of the current market price. The price on any particular day can drop well below or rise above the reasonable market price. Using a spot price would increase the risk significantly of a divergence in price used by the levy from the price faced by those under the NZ ETS.

Transparency and clarity

The fact this methodology is being set out in regulations provides transparency and clarity to those affected by the levy. All three options provide equal transparency and clarity.

Equity

Option one is fairest for those facing the levy as it is likely to produce the most reliable and representative market price.

Option two is less fair as it may produce a price that is not reliable or representative of the market price.

Option three is the least fair as it is likely to produce a price that is not reliable or representative of the market price.

Environmental integrity

The levy has environmental integrity by placing an added cost on SGG. The point in time the carbon price is taken from will not affect the levy's environmental integrity.

Impact assessment

The levy will impact importers of goods containing HFC or PFC, including air-conditioning units and refrigerators. The levy will also impact people who register a motor vehicle for on-road use. This is because the air-conditioning units of motor vehicles contain HFCs.

The impact of the carbon price methodology on the cost to the importer or person registering a motor vehicle is negligible. This assessment is valid whether considering the emission unit used or the timing of the price point. When taking into consideration the commercial price of goods containing SGG, the price difference between the results of each of the options above is estimated to be just over 1 per cent of the value of the good. This is because under the transitional phase measures the highest the price could be is $12.50 for an emission unit. Therefore, the carbon price methodology chosen will not distort competition materially.

Part 2 – Exemption for motor vehicles

Proposal

The only viable option available, other than maintaining the status quo, is creating an exemption under section 244 of the Climate Change Response Act 2002. The exemption would exempt all motor vehicles that were entry-certified prior to 1 July 2013 from paying the levy.

Assessment of options

This option will be assessed against the status quo. For an explanation of the status quo, please refer to 'Problem Definition, Part 2 – Exemption for Motor Vehicles' in this document.

Assessment against evaluation criteria

Efficiency

The benefits of exempting vehicles that were entry-certified prior to 1 July 2013 would exceed the associated costs of not implementing an exemption.

There are costs associated with an exemption for the Government, as the Government would not receive revenue from the motor vehicles that are exempt from the levy.

NZTA advises this would be foregone revenue for the Government, as it is estimated an exemption would affect 52,000 motor vehicles, with an average impact of $3.53 per vehicle. This would reduce levy revenue by approximately $185,000 compared with implementing the levy for vehicles entry-certified prior to 1 July 2013.

However, it was never the intention of the SGG levy to capture vehicles imported prior to 1 July 2013. There are also small administrative costs for the Government for creating an exemption.

There are also environmental costs associated with an exemption. This is because the 52,000 motor vehicles exempt from the levy are not facing the true environmental cost of the SGG contained in the air-conditioning unit of that motor vehicle. However, these vehicles were imported and entry-certified before any other vehicles faced the SGG levy.

In the Government's view these costs, both governmental and environmental, do not outweigh the benefits associated with implementing an exemption, particularly the equity benefits outlined below.

NZTA would realise the largest benefit of implementing an exemption. As outlined in 'Problem Definition, Part 2 – Exemption for Motor Vehicles' in this factsheet, during the initial months of the levy, the NZTA will not be able to collect the SGG levy, as the necessary information to charge the levy will not be available.

The other benefit of an exemption would be to those facing the cost of the levy. An alternative would be the NZTA requiring motor vehicles to be recertified. This would result in greater financial and time costs for motor vehicle owners.

Effectiveness

When compared to the status quo, the exemption would meet the objective of minimising compliance and administration costs, to both the Government and the general public.

Transparency and clarity

Both options would be clear and transparent.

Equity

The exemption would increase equity to owners of vehicles that were entry-certified prior to 1 July 2013, as well as to the NZTA. It would not be equitable to put an obligation on vehicles that were imported and entry-certified before anyone else faced the environmental cost for SGG. The obligation did not apply when those vehicles were certified, therefore it would be inequitable to make vehicle owners recertify, when they were not bound by the levy originally.

Environmental integrity

An exemption would mean approximately 52,000 motor vehicle owners would not face the full environmental cost of the SGG contained in their motor vehicles. This would mean the levy would not meet its intended purpose to capture vehicles that are registered after the entry certification process. An unintended consequence would be vehicles imported before the levy start date (1 July 2013) would be caught as well, even though they should not be.

Impact assessment

An exemption would impact approximately 52,000 motor vehicles. Exempting these motor vehicles would impact on the Government's revenue from the levy by approximately $185,000.

An exemption may have a negative environmental impact, as the exempt motor vehicles would not face the full environmental cost of the SGG they contain. However, capturing these vehicles is not the intention of this levy as those vehicles were imported and entry-certified before a levy was in place.

An exemption would have a positive impact on NZTA's implementation as well as initial implementation of the SGG levy. Without an exemption it would be impractical for the NZTA to collect the SGG levy, as the necessary information to charge the levy would not be available.

These impacts, both governmental and environmental, are outweighed by the positive impacts associated with implementing an exemption.

Consultation questions

Part 1 – Carbon price methodology – consultation questions

1. Do you agree with the proposed carbon price methodology? Please suggest options not discussed here, and, of those options discussed, please say what options should not be considered. In both cases, please explain why.

2. What are the impacts of the proposal discussed? How should we value these impacts?

3. What other impacts and costs have not been identified and/or considered?

4. How would these impacts and costs differ under an alternative approach?

For all your answers please explain why and provide evidence of the impacts and costs.

Part 2 – Exemption for motor vehicles – consultation questions

5. What options should we consider for motor vehicles entry-certified before 1 July 2013? Please suggest options not discussed here, and of those options discussed, please say what options should not be considered. In both cases, please explain why.

6. What are the impacts of the options discussed? How should we value these impacts?

7. What other impacts and costs have not been identified and/or considered?

8. How would these impacts and costs differ under an alternative approach?

For all your answers please explain why and provide evidence of the impacts and costs.

Please note the consultation period for the exemption of motor vehicles is shorter due to an earlier deadline.

Find out more

Further information on the SGG sector in the NZ ETS and the levy system, including commonly asked questions and their answers, can be found at: www.climatechange.govt.nz/emissions-trading-scheme/participating/synthetic-gases/ or phone 0800 CLIMATE (254 628).

Making a submission

The Ministry for the Environment welcomes written submissions on the proposed regulations for the SGG levy.

Part 1: The methodology for setting the carbon price for the SGG levy:

Submissions are due by **5.00pm on 17 May 2013.**

Part 2: Exemption for motor vehicles:

Submissions are due by **5.00pm on 3 May 2013**.

Please send your submission by email to: ETSconsultation@climatechange.govt.nz with the subject field 'SGG submission'.

If you are unable to email your submission then please post it to:

ETS Operational Policy Team
Ministry for the Environment
PO Box 10362
Wellington 6143.

Next steps

Submissions will be analysed by the Ministry for the Environment and reported to the Minister for Climate Change Issues for final decisions.

Updates about the process will be provided on the climate change website: **www.climatechange.govt.nz.**

About submissions

The Ministry for the Environment may publish all or part of any written submission on the Government's climate change website. We will consider you to have consented to such publishing by making a submission, unless you clearly specify otherwise in your submission.

The content of submissions is subject to the Official Information Act 1982. Copies of submissions sent to us will normally be released in response to an Official Information Act request from a member of the public. If you object to the release of any information contained in your submission, please clearly state this in your submission, including which part(s) you consider should be withheld, together with the reason(s) for withholding the information. We will take into account all such objections when responding to requests for copies of, and information on, submissions to this document.

If you do not wish your name and any identifying details in your submission to be released, please clearly state this in your submission. At your request, we will make your submission anonymous before it is published on the climate change website. However, please note that the Ministry for the Environment will not be able to withhold any information if doing so would contravene the requirements of the Official Information Act.

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