

# Climate Change Policy: Proposal for a Discussion Paper on Options to Reduce New Zealand's Greenhouse Gas Emissions Post-2012

Reference number:

CBC (06) 273

## Cover note

On Monday 2 October 2006, the Cabinet Business Committee (CBC) having been authorised by the Chair with power to act, considered the paper *Climate Change Policy: Proposal for a Discussion Paper on Options to Reduce New Zealand's Greenhouse Gas Emissions Post-2012*.

This paper (Ref: CBC (06) 273) and the associated Cabinet minute (Ref: CBC Min 06 17/6) are included. It is important to note that some of the timeframes for completion of work specified in this document are now out of date. More up-to-date information can be found as it becomes available at [www.climatechange.govt.nz](http://www.climatechange.govt.nz).

Office of the Minister Responsible for Climate Change Issues

Chair Cabinet Business Committee

## Proposal

1. I seek Cabinet agreement to use a discussion paper as a basis for stakeholder consultation on options for reducing New Zealand's greenhouse gas emissions post-2012.
2. In addition, I seek Cabinet agreement for the key messages to be communicated in the discussion paper, especially as they relate to the future use of longer-term price-based or alternative measures across key sectors of the New Zealand economy.

## Executive summary

3. In May 2006, Cabinet directed officials to proceed with a number of whole-of-government work programmes to develop climate change policies. One of these work programmes focuses on developing alternative measures and policies to the carbon tax.

4. While a number of the work programmes have a sectoral focus (e.g. transport, forestry and energy), the alternatives to the carbon tax work programme is cross-sectoral. It has major implications for other work programmes in that it discusses New Zealand's policy response in the longer term, i.e. for the period after 2012. Cabinet has agreed that short term (sectoral) policies are to be consistent with long-term policy settings.

5. A key question that the alternatives to the carbon tax work programme is to address is whether New Zealand should consider a price based measure (such as emissions trading – also known as 'cap and trade' - or taxes) after 2012, or whether alternative measures (for example, directive regulation, mandatory measures or other approaches) are preferred. Alternatively, a mix of price and non-price policies may be desired.

6. I seek Cabinet's agreement for officials to develop a discussion paper to aid engagement with the public and key stakeholders on post-2012 policies. Feedback on post-2012 policies will facilitate decisions that Cabinet will subsequently be asked to make on New Zealand's long-term climate change policy direction.

7. I propose that the primary objective of the discussion paper be on developing a consensus for the long-term direction of climate change policies for reducing NZ's greenhouse gas emissions. I intend that the paper be framed in such a way as to reflect the 2005 Review of Climate Change Policies, while still allowing for meaningful consultation with the public and stakeholders as decisions are made on climate change policy going forward. While engagement takes time, and we risk the charge from some quarters that we have been slow to develop a clear policy direction on climate change, this government takes seriously the need to engage with the people of New Zealand and encourage them to be involved in the decision-making process.

8. In line with Cabinet directives, the discussion paper will include an appropriate range of proposals for consultation, including well-developed regulatory and other alternatives to price-based measures. I propose that the discussion paper therefore not contain government proposals or identify any preferred approaches.

9. That said, given the wider strategic importance of decisions on the direction of long-term climate change policy, I recommend that the discussion paper clearly state that, although no decisions have been made, the government has a positive view on the use of economically efficient price-based measures applied broadly across key sectors of the economy in the longer term.

10. A level of uncertainty in developing New Zealand's climate change policies arises from the present uncertainty about the shape of future international agreements on climate change. To the extent of these uncertainties, it will be desirable to build flexibility into long-term policies so that they can adapt to changing conditions, and/or allow for conditionality in if and when, or how stringently, any particular policy measure might be applied. Against this, clearer specification of policies now provides greater certainty for investment and business planning and better guidance for the development of transitional measures.

11. I propose that the discussion paper be available to the general public, as well as stakeholders who are already knowledgeable about climate change policy issues.

## Background

12. While there is still some uncertainty about the shape of future international agreements on climate change, and the mechanisms by which emissions reductions are to be achieved, there is a commitment at the global level that a policy response to climate change is needed and that reductions in emissions from 'business as usual' are required.

13. Concerted international action is proceeding on a number of fronts. The Kyoto Protocol has come into effect and its industrialised members are taking substantial steps to curb their emissions. The 'Asia-Pacific Partnership' between the USA, Japan, China, India, South Korea, and Australia has commenced. It aims to develop and deploy cleaner technologies and it may play an important role in avoiding or moderating the growth of greenhouse gas emissions in developing countries.

14. New Zealand, too, must play its part in reducing emissions. While New Zealand produces 0.2 percent of total global greenhouse gas emissions, our emissions are the 11th highest in the world on a per capita basis. It is in New Zealand's self interest for the world to reduce its global emissions: as a biologically based economy, climate change will impact on our economy and our way of life and we need to ensure that we play our part in supporting a global response. We are also a trading nation and need to be prepared to be on the same footing as our trading partners. There is already talk in Europe of carbon emission-related trade rules.

15. Reducing emissions from 'business as usual' means doing what we do differently (and more efficiently) than at present. Any measures to reduce emissions from 'business as usual' will therefore come at a cost, whether they are price-based, regulatory or other measures. In some circumstances, there may well be, however, some long-term cost-savings to be made from operating more efficiently.

16. Countries that have ratified the Kyoto Protocol, including New Zealand, already face a cost for their greenhouse gas emissions. Countries that have not ratified, notably Australia and the United States, and a number of developing countries are taking other steps (for example, via regulatory measures) to reduce emissions below business-as-usual, and these too have a cost. This cost is effectively devolved, at least partially, to those who meet the cost of complying with such measures.

17. Reductions in emissions from business-as-usual can be achieved in a number of ways, including via sectoral and economy-wide measures. Measures may include non-price based approaches such as directive regulation, mandatory measures or other approaches (such as voluntary measures), or price-based measures. Alternatively, a mix of price-based and non-price based measures may be desired.

18. An important element of decisions on the long-term direction of New Zealand's climate change policies will be the extent to which price-based measures are applied, either across the economy or within specific sectors. Price-based measures can be divided into three main types:

a. Taxes on emissions.

b. Emissions trading (either in the form of a 'cap and trade' regime - this is similar to the fisheries quota management system - or 'baseline and credit'), where emissions rights can be traded among those who need them.

c. Financial incentives, such as capital subsidies, tax incentives, financing programmes (e.g. the Projects to Reduce Emissions programme), or preferential pricing schemes.

19. The first two price-based measures have the effect of "devolving" some of the cost and benefits of reducing emissions to those who emit. This can promote least-cost emissions reduction by giving those responsible for emissions (and removals, notably the carbon dioxide absorbed by forests) powerful incentives to change behaviour in production, capital investment and consumption.

## Alternatives to the Carbon Tax Work Programme

20. In May 2006, Cabinet directed officials to proceed with a whole-of-government work programme for climate change, including alternatives to the carbon tax (CAB Min (06) 18/8).

21. Following consideration of the paper "*Climate Change Policy: Overview and Strategic Direction*", Cabinet noted (POL Min (06) 19/8) that:

- a combination of sectoral and economy-wide measures, including price-based, voluntary, and regulatory measures, is likely to be needed to respond to climate change; and
- a critical assumption for climate change policy is that New Zealand needs to prepare for a probable long term (post-2012) international environment in which a price applies to or a cost is attached to greenhouse gas emissions.

22. The work programme on alternatives to the carbon tax was originally intended to address both long-term (i.e. post 2012) policy settings, as well as options for interim (i.e. pre-2012) policy measures for large greenhouse gas emission emitters (the emissions from this group were specifically targeted by the earlier announced carbon tax). The latter piece of work will now be undertaken as part of the work going forward to develop the New Zealand Energy Strategy.

23. The work programme on alternatives to the carbon tax has particularly strong linkages to:

a. the development of a strategic framework for climate change policy, including consideration of the extent to which New Zealand should prepare for international emissions trading and move toward a situation where all sectors face a cost for greenhouse gas emissions; and

b. the combined energy sector work programme, as noted above, including the development of a New Zealand Energy Strategy and a replacement National Energy Efficiency and Conservation Strategy.

24. In Cab Min (06) 18/8, Cabinet noted that New Zealand's policy response should seek least-cost solutions, and that short-term measures must not be inconsistent with likely long-term solutions. The work programme on alternatives to the carbon tax will prepare Cabinet to make decisions on the use of economically efficient price-based or non-price (e.g. regulatory or other) measures in the longer-term (i.e. post-

2012). Under the work programme, officials are investigating longer-term policy measures, including measures that could be used to introduce a price for greenhouse gas emissions either in key sectors or across the New Zealand economy post-2012.

25. It is important to note that while many of the climate change work programmes have a sectoral focus, the work programme on alternatives to the carbon tax is cross-sectoral and has implications for other work programmes. Decisions as noted above on the use of price-based or non-price measures could affect the strategic development of sectoral policies in the shorter term. Likewise, any decisions to move forward with shorter-term price-based measures in key sectors (e.g. forestry and agriculture) could weigh in favour of policies applying, or moving towards, price-based measures in other sectors in the longer term.

## **Use of a discussion paper for stakeholder engagement**

26. Effective stakeholder engagement is critical as the government works to develop policy options for reducing New Zealand's emissions post-2012.. Even among key stakeholders with a strong interest in climate change policy, there is little common understanding of options for the design of price-based measures as alternatives to regulation and other measures to reduce greenhouse gas emissions.

27. I see an immediate need to create a platform for engaging with stakeholders on price-based and alternative measures (for example, directive regulation, mandatory measures or other approaches) that could be applied across key sectors or the economy as a whole in the longer term. I therefore seek Cabinet's agreement for officials to develop a discussion paper to aid engagement with the public and key stakeholders on policies to reduce emissions post-2012.

28. I intend the discussion paper to stimulate dialogue with stakeholders about these issues. Feedback on post-2012 policies will facilitate decisions that Cabinet will subsequently be asked to make on New Zealand's long-term climate change policy direction.

29. Stakeholder consultation on the discussion paper will assist officials in developing a recommended approach for reducing New Zealand's greenhouse gas emissions post-2012, as well as interim policies for large emitters. A key element of this recommendation is likely to be whether price-based measures, regulatory or other non-price measures, or a mix of each are preferred approaches for climate change policy post-2012.

30. I note that the design of shorter-term measures will continue to fall within the scope of the sectoral work programmes underway (e.g. in the energy, transport, forestry and agriculture sectors).

## Proposed content of the discussion paper

31. In line with Cabinet directives (CAB Min (06) 34/3A), the discussion paper will include an appropriate range of proposals for consultation, including well-developed regulatory and other alternatives to price-based measures.

32. Given its focus on longer-term emission mitigation policies, I propose that the discussion paper not contain government proposals or identify preferred approaches. Instead, I recommend that the paper provide a summary of key issues and ask a series of questions for stakeholders to consider. I propose that the paper focus public discussion on post-2012 policies on two price-based measures – emissions trading and greenhouse gas taxes – in addition to directive regulations and emission reduction agreements (mandatory or voluntary).

33. That said, given the wider strategic importance of decisions on the direction of long-term climate change policy, I recommend that the discussion paper clearly state that, although no decisions have been made, the government has a positive view on the use of economically efficient price-based measures applied broadly across key sectors of the economy in the longer term (i.e. post-2012). I recommend that the discussion paper should note in this respect that any such price-based measures should be consistent with New Zealand's economic and sustainable development interests, and the longer-term international climate change policy framework. I also recommend that Cabinet signal through the paper that shorter-term measures developed under the sectoral work programmes should be compatible with, and not preclude, the implementation of broad price-based measures in the longer term.

34. I propose that the discussion paper be available to the general public, as well as stakeholders who are already knowledgeable about climate change policy issues and have a particular interest or stake in the use of broad price-based or other measures.

35. I propose that the discussion paper address the following issues:

a. The role of price-based and other options as possible measures for managing greenhouse gas emissions and allocating costs in the New Zealand economy over time;

b. How to assess the effectiveness of specific measures such as emissions trading, greenhouse gas taxes, directive regulation, and emission reduction agreements (voluntary or mandatory) in supporting New Zealand's longer-term climate change policy goals.

36. Consistent with the strategic direction for climate change policy development articulated in the Cabinet paper entitled "*Climate Change Policy: Overview and Strategic Direction*" (POL (06) 268), I propose that the discussion paper should include the following key messages:

a. While there is uncertainty about the nature of future international climate change obligations, it is reasonable to expect that in the future, there will be increased international efforts to mitigate climate change, and this will, either directly or indirectly, impose an associated economic cost.

- b. As the world's major industrialised economies move toward a low-carbon future, countries can apply price-based measures to support least-cost mitigation and to lessen the risk of investment decisions that lock assets into emissions-intensive production and that could harm their international competitiveness in the longer term.
- c. In the design of New Zealand's climate change policy, it will be important to recognise the international context of actions taken in New Zealand, including the need for the world's major emitters to take effective action.
- d. The government expects that, over time, a mix of sectoral and economy-wide measures, including price-based, regulatory and voluntary measures, will be needed to achieve the integration of New Zealand's climate change and other sustainable development objectives.
- e. In the longer term, a broad price-based measure such as emissions trading could potentially be applied across major emitting and sequestering sectors of the New Zealand economy.
- f. Depending on the future international framework for climate change policy, a price-based measure with international linkages could allow New Zealanders to access least-cost mitigation opportunities in other countries.
- g. Although no decisions have been made, the government has a positive view on the use of economically efficient price-based measures applied broadly across key sectors of the economy in the longer term (i.e., post-2012), provided such measures are consistent with New Zealand's economic and sustainable development interests and the longer-term international climate change policy framework.
- h. A level of uncertainty in developing New Zealand's climate change policies arises from the present uncertainty about the shape of future international agreements on climate change. To the extent of these uncertainties, it will be desirable to build flexibility into long-term policies so that they can adapt to changing conditions, and/or allow for conditionality in if and when, or how stringently, any particular policy measure might be applied. Against this, clearer specification of policies now provides greater certainty for investment and business planning and better guidance for the development of transitional measures.
- i. Shorter-term measures developed under the sectoral work programmes should not preclude the implementation of broad price-based measures in the longer term.

## **Process for release of the discussion paper**

37. If Cabinet agrees to the preparation of a discussion paper containing the key messages articulated in this paper, I will report back to Cabinet with a full and final version of a discussion paper for Cabinet's approval.

38. If and when a discussion paper is approved, I will release it for public submissions. Stakeholders and the general public would be invited to make written submissions within 6-8 weeks. I also intend that the discussion paper be used as a framework for discussions between officials and stakeholders at workshops and smaller meetings.

39. As I have already outlined to Cabinet (POL Min (06) 19/8), the release of this discussion paper has strong links with other consultation activities under the sectoral work programmes (including agriculture and forestry). If possible, I propose releasing all programmed discussion documents at the same time, which is likely to be in late October or early November 2006.

40. Stakeholder engagement on the discussion paper may also coincide with formal consultation on several sectoral work programmes including agriculture and forestry. Formal consultation on both the New Zealand Energy Strategy and the replacement National Energy Efficiency and Conservation Strategy is expected to begin in November 2006. This consultation could include the possibility of applying to the energy sector some or all of the types of measures addressed in the discussion paper. Consultation on the discussion paper will be coordinated to the extent practicable with consultation on the energy strategies.

41. The work programme on alternatives to the carbon tax is scheduled to report back to Cabinet in November 2006 (Cab Min (06) 18/8 refers). Given the time needed for adequate consultation on the discussion paper, I recommend deferring the report-back to Cabinet on this work programme until February 2007. Based on the outcome of that report-back and subsequent Cabinet decisions, officials will then focus in more detail (including design detail) on a narrower set of options for further analysis. Under current planning, a second stage of formal consultation under this work programme will be undertaken in 2007. A further and final report-back to Cabinet is then envisaged.

## **Consultation**

42. The following departments were consulted on this paper: The Treasury, Te Puni Kokiri, the Ministry of Economic Development, the Ministry of Agriculture and Forestry, the Ministry of Foreign Affairs and Trade, the Department of Prime Minister and Cabinet, the Ministry of Transport, the Ministry of Research, Science and Technology, and the Energy Efficiency and Conservation Authority.

43. Officials met with some industry stakeholders to discuss the content and purpose of the discussion paper in general terms. These stakeholders expressed strong support for the use of a discussion paper for the purpose outlined above.

## **Financial implications**

44. There are no fiscal, financial or economic implications of decisions sought by this paper.

## **Legislative implications**

45. There are no legislative implications of decisions sought by this paper.

## Publicity

46. Communication around the future release of the discussion paper would be integrated with the climate change communication and stakeholder engagement work programme led by the Ministry for the Environment.

47. I propose the public release of this paper with appropriate withholdings.

## Recommendations

48. As Minister Responsible for Climate Change Issues, I recommend that the Committee:

1. **Note** that the work programme on alternatives to the carbon tax focuses on longer-term policy measures that could be used to introduce a price for greenhouse gas emissions across the New Zealand economy post-2012;

2. **Note** that this work programme also considers alternative measures (for example, directive regulation, mandatory measures and other approaches) with a focus on emission reduction agreements and the use of regulations;

3. **Note** that this work programme contains strong linkages to the New Zealand Energy Strategy and the replacement National Energy Efficiency and Conservation Strategy, and that stakeholder consultation should be coordinated to the extent practicable with these initiatives;

4. **Note** that there is an immediate need to create a platform for engaging with stakeholders on policies to reduce greenhouse gas emissions (both price-based and alternative measures) that could be applied across the economy in the longer term;

5. **Agree** to the use of a discussion paper as a basis for stakeholder consultation on policy options to reduce New Zealand's greenhouse gas emissions post 2012;

6. **Agree** that the primary objective of the discussion paper is on developing a consensus for the long-term direction of policies to reduce New Zealand's greenhouse gas emissions and that meaningful engagement with stakeholders is an essential part of this process;

7. **Agree** that the discussion paper should include the following key messages:

7.1. While there is uncertainty about the nature of future international climate change obligations, it is reasonable to expect that in the future there will be increased international efforts to mitigate climate change, and this will, directly or indirectly, have a moderate economic cost;

7.2. As the world's major industrialised economies move toward a low-carbon future, countries can apply price-based measures to support least-cost mitigation. Such measures can lessen the risk of investment decisions that lock assets into emissions-intensive production and compromise international competitiveness in the longer term;

7.3. In the design of New Zealand's climate change policy, it will be important to recognise the international context for actions taken in New Zealand, including the extent to which the world's major emitters take effective action;

7.4. The government expects that, over time, a mix of sectoral and economy-wide measures, including price-based, regulatory, and voluntary measures, will be needed to achieve New Zealand's climate change and other sustainable development objectives;

7.5. In the longer term, a broad price-based measure such as emissions trading could potentially be applied across major emitting and sequestering sectors of the New Zealand economy;

7.6. Depending on the future international framework for climate change policy, a price-based measure with international linkages could allow New Zealanders access to least-cost mitigation opportunities in other countries;

7.7. Although no decisions have been made, the government has a positive view on the use of economically efficient price-based measures applied broadly across the economy in the longer term (i.e., post-2012), provided such measures are consistent with New Zealand's sustainable development and the longer-term international climate change policy framework;

7.8. A level of uncertainty in developing New Zealand's climate change policies arises from the present uncertainty about the shape of future international agreements on climate change. To the extent of these uncertainties, it will be desirable to build flexibility into long-term policies so that they can adapt to changing conditions, and/or allow for conditionality in if and when, or how stringently, any particular policy measure might be applied. Against this, clearer specification of policies now provides greater certainty for investment and business planning and better guidance for the development of transitional measures; and

7.9. Shorter-term measures developed under sectoral work programmes should not preclude the implementation of broad price-based measures in the longer term;

8. **Note** that while the discussion paper would inform stakeholders about the general application of price-based and alternative measures pre-2012, the design of specific shorter-term measures falls within the scope of the sectoral climate change work programmes underway;

9. **Invite** the Minister Responsible for Climate Change Issues to report back to Cabinet to seek approval for the release of the finalised discussion paper;

10. **Agree** to defer the first report-back to Cabinet on this work programme (CAB Min (06) 18/8) until February 2007 given the requirement for adequate consultation on the discussion paper;

11. **Agree** that the first report-back to Cabinet following consultation on the discussion paper will recommend a preferred approach for reducing New Zealand's greenhouse gas emissions post-2012;

12. **Note** that, subject to Cabinet decisions at the time of the first report-back in February 2007, a second stage of formal consultation under this work programme will be undertaken later in 2007, focusing on the design detail of a narrower (and

possibly preferred) set of policy options for reducing New Zealand's greenhouse gas emissions post-2012;

13. **Note** that the second stage of formal consultation under this work programme will be coordinated where possible with consultation on other climate change work programmes; and

14. **Agree** to the public release of this paper by the Minister Responsible for Climate Change Issues, with appropriate withholdings.

Hon David Parker Minister Responsible for Climate Change Issues