



## Moderated NZ ETS: Fishing sector allocation

<b>Date:</b>	17 August 2009	<b>MfE Priority:</b>	URGENT
<b>Security Level:</b>		<b>Number of Attachments:</b>	Nil
		<b>MfE Ref No:</b>	09-B-00397

## Action Sought

	Action Sought	Deadline
Minister for Climate Change Issues  Hon Dr Nick Smith	<p><b>Agree</b> that the NZ ETS shall specify free allocation to the fishing sector as 700,000 NZU if the entry date for liquid fossil fuels is 1 July 2010 or 840,000 NZU if the entry date for liquid fossil fuels is 1 January 2010.</p> <p><b>Indicate</b> your preference for the recipients of free allocation to be <b>either</b></p> <ul style="list-style-type: none"> <li>▪ fishing vessel operators (officials' preference) <b>or</b></li> <li>▪ quota owners</li> </ul> <p><b>Refer</b> this briefing to the Minister of Fisheries for information.</p>	31 August 2009

## Ministry for the Environment Contacts

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		(cell)	(work)	
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## Executive Summary

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On 10 August 2009 Cabinet considered a proposal that legislation shall specify a total number of units for free allocation to the fishing sector and that this number shall be equivalent to 90% of 2005 emissions for two and a half years (i.e. to match the reduced price period), adjusted for a 2:1 progressive obligation being in place.

We recommend that the number placed in legislation is based on a Ministry of Fisheries fuel consumption estimate for 2005 of 216 million litres. We believe this is the best available estimate. This amount of fuel use would result in 700,000 emissions units being granted to the sector. If the entry date for liquid fossil fuels was moved to 1 January 2010, it would be consistent to increase this number to 840,000 emission units to match the reduced price period.

Arguments exist for either quota owners or fishing vessel operators to receive the free allocation. While allocation could be implemented for either group, officials believe that the stronger argument is for fishing vessel operators to receive the free allocation. Fishing vessel operators will be the ones most likely to bear the costs of the NZ ETS over the time free allocation is given. Furthermore, allocation can be more effectively targeted to fishing vessel operators than quota owners.

A possible shift forward of entry date for the liquid fossil fuels sector will increase any delays between the fishing industry bearing ETS costs and receiving allocation. Officials do not feel this is a serious concern given that both allocation and impacts on fuel price will be relatively small (estimated to be in the order of 3 cents per litre prior to 2013). Regardless, officials will consider ways to streamline the allocation process to mitigate this issue (this would require legislative amendments).

## Recommended Action

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### We recommend that you:

- (a) **Agree** that the NZ ETS shall specify free allocation to the fishing sector as 700,000 NZU if the entry date for liquid fossil fuels is 1 July 2010 or 840,000 NZU if the entry date for liquid fossil fuels is 1 January 2010. **YES/NO**
- (b) **Indicate** your preference for the recipients of free allocation to be **either**
- fishing vessel operators (officials' preference) **or** **YES/NO**
  - quota owners **YES/NO**
- (c) **Refer** this briefing to the Minister of Fisheries for information **YES/NO**

John Scott  
**Acting Manager**  
**Emissions Trading**

**Date**

Hon Dr Nick Smith  
**Minister for Climate Change Issues**

**Date**

## **Purpose of Report**

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1. On 10 August 2009 Cabinet considered a proposal that legislation shall specify a total number of units for free allocation to the fishing sector and that this number shall be equivalent to 90% of 2005 emissions for two and a half years, adjusted for a 2:1 progressive obligation being in place. This briefing provides advice on an appropriate number of emission units.
2. You have also stated that you are interested in:
  - Potentially moving the entry date for liquid fossil fuels forward to 1 January 2010
  - The possibility of giving free allocation to quota owners rather than fishing vessel operators
3. This briefing discusses the implications of these two changes for the fishing sector allocation.

## **Implications of a possible 1 January 2010 entry date for liquid fossil fuels**

### Costs will occur before allocation is received

4. Bringing the entry date forward for liquid fossil fuels will mean that fishing vessel operators face increased costs for a longer period of time before they receive any free allocation. However, with the introduction of a price cap and a progressive obligation the scale of the cost increases faced by fishers will be relatively small, in the order of three cents per litre of fuel.
5. Given the impact of the NZ ETS during the reduced price period is lessened and the allocation pool is relatively small, officials consider that it is not necessary that fishing vessel operators receive free allocation before fuel prices increase. Nonetheless, officials will consider options for a simplified allocation process for the fishing sector.

### Size of allocation pool

6. The proposal considered by Cabinet reduced the free allocation pool from 3 times 90% of 2005 emissions to 2.5 times 90% of 2005 emissions in order to match the reduced price period that applied to liquid fossil fuels. If the liquid fossil fuel sector enters on 1 January 2010, for the sake of consistency, officials would recommend the size of the pool should increase back to 3 times 90% of 2005 emissions (adjusted to take account of the progressive obligation).

## **Number of emission units to be stated in the legislation**

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7. The Ministry of Fisheries has recently conducted a modelling and surveying exercise to provide an estimate over the total quantity of fuel used by New Zealand registered fishing vessel operators in 2005.
8. The analysis used two converging methods to produce a fuel use estimate: a direct method and an indirect method.

9. The direct method involved surveying the entire New Zealand fishing industry to obtain actual information on fuel consumption in 2005. The indirect method calculated fuel consumption by using relevant information held in the Ministry of Fisheries databases.
10. Preliminary work to assist the development of the indirect methodology produced an estimate of 190 million litres. However, further refinement and a direct survey of the fishing fleet<sup>1</sup> produced a far more reliable estimate of 216 million litres.
11. It is estimated that the 216 million litre level of annual fuel-use would generate approximately 620,000 tonnes of CO<sub>2</sub>-e. A 90% level of free allocation would therefore equate to 560,000 emission units being allocated per year. If this 90% level were granted for 2.5 years (July 2010 to December 2012) the total pool of units would be 1.40 million emission units. Reducing this number by a half to account for the progressive obligation that will be in place over July 2010 to December 2012 leaves 700,000 emission units.
12. If the decision is taken to move the entry date for liquid fossil fuels forward to 1 January 2010 it would be consistent with earlier Cabinet proposals for the amount of free allocation to increase this amount to 840,000 emission units.

#### International trade implications

13. [withheld].
14. [withheld].
15. [withheld].

#### **Recipients of free allocation**

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16. You have expressed an interest in the arguments over who the free allocation should be granted to: fishing vessel operators or the owners of quota.

#### Impacts of the NZ ETS in the short term

17. Quota owners are often also fishing vessel operators, but where this is not the case, it will be vessel operators that will bear the majority of the impacts of the ETS within the short term period during which free allocation will be provided, for the following reasons:
  - Markets will take time to adjust for the value of quota to be fully impacted by either the cost of emissions or free allocation.
  - If it remains profitable for fishers to fish, quota owners do not have to lower the price of Annual Catch Entitlement (ACE), and fishers, who pay for fuel,

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<sup>1</sup> Results were returned for nearly 2/3rds of the industry's installed capacity when expressed in terms of kilowatt-hours, and based on calculated estimates of total consumption, nearly 70% of the total consumption for 2005 is now known from actual figures

are likely to absorb much (or all) the cost. It is only when it is no longer profitable for fishers to fish, that quota owners would have no choice but to lower the price of ACE.

- Operators can have large sunk costs and may not always be in a position to stop and start other careers, i.e. they are not necessarily in a good negotiating position.
- Quota owners will always seek to maximise the value that they can receive for their ACE in the market. Giving free allocation to quota owners is unlikely to influence the price at which their ACE will be sold.

#### Operators can use allocation to change behaviour

18. It is fishing vessel operators who are in a position to reduce emissions by changing fishing practices. Giving free allocation to fishing vessel operators allows them to use this allocation to adopt more efficient fishing technologies and/or trial more efficient fishing techniques, if they so choose.

#### Practicalities of allocation favour operators

19. Making allocation to fishing vessel operators should prove relatively straight forward because allocations can be made on the relatively simple basis of fuel used in a given year or years. There will be a close link between the amount of fuel used by a given fishing vessel operator and the impact of the NZ ETS on them.
20. Making allocations to quota owners may prove more problematic, if it is to be allocated on an annual basis. Making allocations on the basis of readily traded commodities risks a lack of transparency and gaming.
21. The impact of the NZ ETS on operators will differ according to fishing method – some fishing methods are more fuel intensive than other fishing methods. If allocations are made to quota owners, determining a formula to distribute allocation between quota owners that takes different fishing methods, and resulting differences in fuel use, into account would be contentious. This formula would probably need to be stated in legislation.
22. Allocation could be given as a lump sum or annually to either fishing vessel operators or quota owners. Allocating to fishing vessel operators will likely require time for individual operators to produce data on fuel use.
23. The numbers of persons owning quota (approximately 1600) and the number of commercial fishing vessels (approximately 1300) are both large, so a reasonable amount of administrative effort would be required for either option.