



ETS Amendments: Price Controls and Intensity-Based Allocation

Date:	3 July 2009	MfE Priority:	Non-urgent
Security Level:		Number of Attachments:	Two
		MfE Ref No:	09-B-01800

Action Sought

	Action Sought	Deadline
Minister for Climate Change Issues Hon Dr Nick Smith	Note.	None.
Associate Minister for Climate Change Issues (International Negotiations) Hon Tim Groser	Note.	None.

Ministry for the Environment Contacts [if required]

Name	Position	Telephone		1st Contact
		(cell)	(work)	
[withheld]	Senior Analyst, Emissions Trading Policy	[withheld]	[withheld]	✓
John Scott	Acting Manager, Emissions Trading Policy	[withheld]	04 439 7573	
Stuart Calman	Director, Climate and Risk Directorate	[withheld]	04 439 7571	

Executive Summary

You have requested papers detailing how the following amendments to the New Zealand Emissions Trading Scheme (NZ ETS) might be implemented:

- An initial low price phase from July 2010 – December 2012 implemented through a 50% progressive obligation, operating alongside a \$25 price cap.
- An Australian-style intensity-based approach to free allocation to the industry sector.

Further to the attached papers, officials are preparing a draft note for you to discuss with your Ministerial colleagues on a full package of amendments to the NZ ETS. This includes the above proposals, as well as amendments to the forestry, agriculture and fisheries sectors, introduction of a '50 by 50' target, and other minor and technical amendments. The draft note will be sent to you shortly.

In summary, with respect to the proposed low price phase:

- A low price phase operating as a 50% progressive obligation (with free allocation at 50% of the normal level) combined with a \$25 price cap would have fiscal costs of \$600m if applied from July 2010 to December 2012 (as a comparison, costs would be \$320m if applied from July 2010 to December 2011). This assumes forestry is excluded from the progressive obligation.
- To avoid risks of arbitrage during the phase, initial thinking is that units issued under the price cap would need to be for immediate surrender and all exports would need to be banned.
- Establishment of the price cap and progressive obligation will require amendments to the Climate Change Response Act (CCRA). Exports can be banned through existing regulatory powers.
- There is a strong case to support your preference to exclude deforestation liabilities from the progressive obligation and to issue units to post-1989 forests at normal levels. This will, however, require careful explanation and justification to stakeholders. The ban on exports could be perceived as having a disproportionate impact on the forestry sector, and the attractiveness of the ETS to post 1989 foresters.

With respect to proposed intensity-based allocation to the industry sector:

- Further analysis may follow once consultants Covec have finalised their report on the detailed implications of applying the CPRS allocation design features to the NZ ETS.
- In deciding how to implement an Australian allocation approach in New Zealand, Ministers will need to decide:
 - Whether to apply the Australian eligibility thresholds, or to develop New Zealand-specific thresholds. It is important to note that the CPRS thresholds are consistent with international evidence that indicates only a small number of activities (with high levels of emissions intensity) face significant competitiveness impacts. However, adopting the CPRS thresholds is likely to result in certain industries receiving a lower level of allocation than they may expect.
 - Whether to remove or retain the total cap on free allocation, noting that the former is more consistent with an intensity-based allocation but will create fiscal uncertainty.
 - Whether to adopt the Australian levels of assistance; and, if so, whether to apply the 'Global Recession Buffer'.

- How to implement Carbon Pollution Reduction Scheme allocative baselines, which are based on average activity emissions.
 - Whether to adopt the Australian phase-out rate, noting the long-term fiscal costs this implies; to retain a phase-out rate similar to the CCRA timeframes; or to set a phase-out rate between the CCRA and CPRS timeframes.
 - Whether to adopt an Australian-style five year review mechanism for free allocation.
- Given the potential fiscal liabilities (and economic impacts) Ministers will face trade-offs between eligibility thresholds, levels of assistance and phase-out rates. Being more generous on one aspect (for example, thresholds) is likely to imply being less generous on others.
 - On balance, it is desirable to specify as many key design features as possible on the face of the bill. If a large number of these design features are left to regulations it will likely jeopardise preparations for the entry of the stationary energy and industrial processes sectors between December 2009 and July 2010. However, it may not be possible to specify thresholds on the face of the bill if detailed New Zealand-specific thresholds which deviate significantly from the CPRS need to be developed. In addition, Ministers will need to note that specifying these elements on the face of the bill will reduce flexibility to harmonise with the CPRS should design features change in Australia.
 - There will be a need to amend the process for preparing an allocation plan and determinations over individual firms' entitlements under the CCRA, if July 2010 is to be implemented.

Recommended Action

We recommend that you:

- | | |
|--------------------------------------|-----------------|
| (a) Note the attached papers. | Yes / No |
|--------------------------------------|-----------------|

Stuart Calman Director Climate and Risk Directorate	Date
--	-------------

Hon Dr Nick Smith Minister for the Environment Minister for Climate Change Issues	Date
---	-------------

Hon Tim Groser Associate Minister for Climate Change Issues (International Negotiations)	Date
--	-------------