Submission - ETS Review – Other Issues

Sustainability Council of New Zealand

Review Needs to Focus on Architecture and Devising a Plan

In our February submission on the priority issues, the Council addressed the questions of the "one-for-two" surrender concession and the fixed price option. This submission examines higher level issues.

While the terms of reference for the review are broad enough to carry an objective of preparing the economy for more stringent international carbon reduction commitments and higher carbon prices (5b), the review prejudges the high level architecture for addressing climate change and focuses simply on low level tweaking of the ETS dials.[1] Yet any stand back review of that architecture and framework would quickly be drawn to the history of short term political imperatives guiding past settings, and the lack of a long term plan for seriously tackling emissions.[2]

Further, there is not even a basic set of accounts or forward financial projections on which to evaluate the past and consider future scenarios. While the MFE report evaluating the ETS notes that modelling has been undertaken, the results of that have not been shared in even the most limited form – as was the case for the 2011 review. Thus the information base available to submitters is unreasonably limited.

This submission argues that a key focus for the review should be the establishment of a carbon budgeting process, as a framework in which the ETS would sit as pricing instrument.

Carbon Budgeting the Required Framework

A carbon budget is essential to planning for serious emission reductions. It details the expected carbon flows and associated financial commitments for a country.

New Zealand has emissions reduction targets but no plan for how to meet them. Nor does it maintain detailed forward looking carbon accounts, and so no official statement of the future cost of facing up to the carbon challenge. The ETS and a snatch of minor policies do not amount to a plan or a carbon budget. They are simply tools.

In the past, the ETS is used mainly to manage the financial risks to the government arising from forestry activities. The harvesting of trees is fully priced, while its impact on most other parties is limited through varied start dates and precise targeting of rebates, compensation and gifts. The ETS reduced gross emissions by less than 1% during its first five years, and these are projected to keep rising out to at least 2030.

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[1] The objective states: "ensure the New Zealand economy is well-prepared in the context of a strengthening international response to climate change and potentially higher carbon prices in the 2020s".

[2] See Annex 1, Sustainability Council, *The Carbon Budget Deficit*, September 2012. See section three in particular.

The review terms of reference note in particular the emission reduction obligations in the 2020s when gross emissions are projected to far exceed domestic credits from sequestration. The expected shape of this period was known from the time of the original design of the ETS and in order to balance the expected external carbon deficit, the original ETS legislation set the scheme so that it would ultimately raise enough revenue for the government to purchase the required volume of offsetting international carbon credits. This would have involved annual ETS revenues rising to around $2 billion a year at a carbon price of $25/t.

However, during its first five years ETS expenses were more than double the revenue the scheme brought in. A little under half those expenses were payments for forests absorbing carbon. The rest was various slabs of corporate welfare and compensation payments that ate out all the ETS income and more.

Overall, official figures show the government's carbon accounts in deficit by 51 Mt for 2008 to 2012 – the period when New Zealand took a commitment under the Kyoto Protocol. This is the total of the ETS accounts and Kyoto accounts over that time. The value of this carbon budget deficit to the taxpayer depends on the carbon price assumed but is $1.3 billion at the government's $25/t price. Revenues since have continued to fail to cover expenses so the ETS remans a tax that is not even paying its way.

In carbon accounting terms, the ETS was converted from a scheme scheduled to collect serious amounts of revenue after an initial transition period, into one that is currently perpetuating the transitional arrangements indefinitely and failing to properly provision for future carbon costs.[3] Future taxpayers will have to make up for the bills that today's emitters are not paying. The ETS has acted to transfer climate debt and risk to our children.

A Climate Commission

Decisions on climate policy, such as the detailed settings of the ETS, result in quantifiable changes in total emissions. At present, the implicit carbon budgets set by those decisions are not geared to achieving any overall emissions outcome. So New Zealand is left with emissions reduction targets but no plan to meet them.

Pressure will mount on New Zealand to actually reduce emissions and achieve quantitative targets. Carbon budgeting becomes key under these circumstances because it puts outcomes first. It takes targets, assesses the options, and describes an overall plan for achieving those outcomes.

Carbon budgets are usually driven by targets specified in legislation. In order to provide some flexibility, targets are locked in only at key intervals. In between these milestones, a series of five-year budgets are progressively struck that guide decarbonising of the economy within the legislated boundaries.

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[3] See Annex 2, Sustainability Council, *New Zealand's Climate Change Targets, Projections, and Liabilities*, December 2014.

A Climate Commission would be part of an overall reform package for New Zealand. The Commission would be responsible for working with stakeholders to explore options and their costs, in order to devise sector action plans that build into the carbon budgets required. This process involves estimating the impact of pricing instruments and non-price regulatory measures, and testing combinations against the government's financial constraints.

Carbon budgeting becomes the process that integrates the ETS, complementary measures, and financial limitations. It brings together future visions, policy preferences, short and long term options, to resolve these and issues surrounding foreign credits into a projection for how the nation's emissions will be shaped in future. This includes working through when setting a price on carbon is sufficient, and when non-price measures need to be employed in substitute or as complementary measures. The overall set of actions becomes the plan that is embodied in a five-year carbon budget.

An early task for a Carbon Commission would involve evaluating domestic emission reduction options to allow domestic targets to be specified that would operate as minimum settings, irrespective of international obligations.

Contact:
Sustainability Council
PO Box 24304, Wellington
T: 04-9133655
E: council@sustainabilitynz.org