



Parliamentary Commissioner  
for the **Environment**  
Te Kaitiaki Taiao a Te Whare Pāremata

# Submission to the Finance and Expenditure Select Committee

on the

# Climate Change Response (Moderated Emissions Trading) Bill

13 October 2009

## Summary of recommendations

Allocation of free carbon credits should only be granted if there is a genuine reason for it, and these reasons should be stated publicly for each particular activity, industry or sector that receives allocation.

New Zealand should not align itself with Australia's proposed scheme.

A cap on the number of carbon credits freely allocated is vital to create the right incentives, and to reduce fiscal risk to the Government and policy uncertainty for business.

The phase-out of free carbon credits is far too slow. The phase-out rate of allocation should specify the latest year that allocation will be given.

Allocation to the agriculture sector should be reviewed, because current plans are inadequate for many reasons.

Transparency, which is critical for building public trust in the scheme needs to be increased, particularly regarding allocation. There are two clear ways to do this:

- The number of free credits that are allocated, as well as the rationale for it, should be reported each year, by activity, industry or sector, by the Registry for emissions units.
- Greater scrutiny to past and future allocation should be applied during the review process.

Allocation provided to protect competitiveness should be re-assessed more regularly than 5 yearly, and a mechanism to fast-track allocation changes should be created.

The provisions that are meant to reduce the negative impacts of the ETS on the tree weed problem should be strengthened.

## Introduction

Climate change is the biggest environmental challenge of our time. As the Parliamentary Commissioner for the Environment, much of my work relates to this issue in some way or another, and some has directly involved the Emissions Trading Scheme (ETS).<sup>1,2,3,4</sup>

The purpose of New Zealand's Emissions Trading Scheme is to:

*“support and encourage global efforts to reduce greenhouse gas emissions by assisting NZ to meet its international obligations under the Convention and the Protocol, and by **reducing New Zealand's net emissions below business-as-usual levels.**”<sup>5</sup>*

For New Zealand to reduce emissions over the long term we must alter the way we produce and use goods and services, in order to make the transition to a low carbon-intensive economy. An ETS is the primary tool for achieving this transformation.

An ETS works by putting a price on greenhouse gas emissions. This means that those who are responsible for emissions, pay for emissions. This price signal incentivises emissions reductions, investment in low-carbon technology, and carbon sequestration.

But anything that weakens this price signal reduces the effectiveness of the ETS.

Unfortunately, some of the proposed amendments almost remove the price signal altogether for some sectors, and particularly over the next few years.

My greatest concern with the proposed amendments is the changes to allocation after 2012. The allocation of free carbon credits to industrial processes, industrial heat generation and petroleum refining sectors is extremely generous. Using the industry average baseline for allocation instead of aiming for better, the lack of a limit to the number of credits given away, and the increasingly slow phase-out, all result in allocation at very high levels. This essentially removes the price signal to this emissions-intensive sector, where New Zealand needs a carbon price signal the most.

Removing the price signal doesn't remove the cost of emissions, since the taxpayer must pick up the tab. And without the incentive to invest in low carbon-intensive technology, emissions will continue to rise. This is not consistent with the stated purpose of the ETS.

I am also concerned about the level of transparency and accountability - essential to build public trust in the scheme. That is why the requirement for periodic reviews of the ETS in the proposed amendments is a welcome improvement.

But greater disclosure is needed. The number of carbon credits allocated for free to each sector should be reported publicly and annually. Also, the rationale for the allocation of free carbon credits to particular sectors of the economy should be re-assessed more regularly than every 5 years.

In this submission I also discuss the impact of the ETS on wilding pines, which are a particular interest of mine. I am pleased to see that improved eligibility to get a carbon liability exemption for wilding pine control is proposed. I am also pleased to see that the proposed amendments include a requirement that land comply with the Biosecurity Act to

be eligible to earn carbon credits. However, in both cases these provisions need to be strengthened, and I recommend ways to do so in this submission.

In this submission I make 13 recommendations to the Select Committee, discussed in four sections:

1. Allocation of free carbon credits
2. Agriculture
3. Transparency, accountability and trust
4. Tree weeds and the ETS

I would appreciate the opportunity to speak to this submission.

# 1. Allocation of free carbon credits

At the end of 2012 the New Zealand government must surrender sufficient carbon credits (also called units) to cover our net emissions for the first commitment period (2008-2012) under our Kyoto obligation. To help meet this obligation, New Zealand has been assigned 310 million credits<sup>6,7</sup> for the first commitment period. This reflects 5 years of net emissions at 1990 levels, in line with our Kyoto emission reduction commitment.

What the government does with these assigned credits will determine how quickly, easily, and cheaply the New Zealand economy transitions to being less carbon intensive, and ultimately, how much our international obligations cost the country.

The government can hold on to the credits until they are required at the end of the commitment period, or sell them, or give them away. Giving away credits domestically (as NZUs) is called allocation.

*Allocation refers to the government giving away emission credits – that is, the right to emit 1 tonne of carbon dioxide equivalent per credit.*

**Allocation is costly.** Each credit that is given away rather than kept or sold is a real dollar loss to the taxpayer. And there is another cost: it lessens the incentive to invest in low-carbon technology and emissions reductions. Generous and unlimited allocation that is promised to last a long time –whether or not it actually does - removes the push to transform to a low carbon-intensive economy. This is probably the biggest cost of all.

## Allocation justification

**Allocation should only be granted if there is a genuine reason for it - and these reasons should be stated publicly.**

Reasons to allocate to firms or individuals include compensating for asset value loss, protecting competitiveness, and incentivising desirable behaviour. How many credits are allocated to whom and for how long should be commensurate with the reason for giving it. The principle of Parliamentary scrutiny in the Public Finance Act<sup>8</sup> should also apply to allocation.

Given the large taxpayer expense, the reason for allocating to a particular sector should be transparent. For example, if the reason is to avoid job losses, the average amount spent on protecting each job should be publically available. One case-study showed that the allocation at one plant equated to \$109,000 per job per year.<sup>9</sup>

Recommendation 1:

**I recommend that notification of intention regarding New Zealand units explicitly specify the justification/reasons for any free allocation of carbon credits to any particular activity, industry or sector.**

This could be achieved by amending clause 22, new section 70(2) in the Climate Change Response (Moderated Emissions Trading) Amendment Bill by adding a new subsection *"(d) the specific reasons for any allocation of New Zealand units free of charge to any activity, industry or sector."*

**Alignment with Australia**

The most significant changes proposed in the amendment bill align New Zealand allocation to the industrial processes and agriculture sectors with the **proposed** Australian allocation plan<sup>10</sup>. Agriculture is discussed further in section 2 of this submission. The explicit intention is to protect the competitiveness of New Zealand firms relative to their Australian counterparts. But this justification is poorly founded.

As Treasury analysts say, *"there is no clear analytical basis for the proposal to align some key design elements of the New Zealand ETS with those in the currently proposed Australian CPRS"<sup>11</sup>. For example there is no discussion of the overall suitability or benefits of applying these elements to New Zealand unique emissions profile and industrial structures."*  
<sup>10</sup>

Aligning with Australia limits how New Zealand may interact with the emissions trading schemes of other countries. For example, under the Kerry-Boxer bill, currently before the United States senate, credits from countries *"not subject to [...] mandatory absolute tonnage limits"* do not qualify under their scheme<sup>12</sup>. This means that, by aligning with Australia on the lack of an allocation cap, New Zealand may rule out the United States as a possible market for New Zealand credits.

Recommendation 2:

**I recommend that New Zealand not align its allocation plan with the proposed Australian Carbon Pollution Reduction scheme.**

The Australian Carbon Pollution Reduction Scheme is simply a proposal at this stage. Much could change before, and if, their scheme becomes law. The Government may wish to copy elements of Australian proposals. But to explicitly lock our scheme into whatever Australia does, by law, as the proposed amendments do in many places, is very risky.

Recommendation 3:

**I recommend that all references to the proposed Australian Carbon Pollution Reduction Scheme be deleted from the Climate Change Response (Moderated Emissions Trading) Amendment Bill.**

## Allocation cap

The proposed amendments change the way credits are given to the industrial processes, industrial heat generation, petroleum refining and agriculture sectors, from using an historical emissions basis to an intensity basis. Under these changes it is not proposed to put any limit, called a cap, on the number of credits allocated to these sectors.

But, there are allocation caps for the fisheries and forestry sectors. More generous treatment of industrial processes, industrial heat generation, and petroleum refining sectors does not appear to be justified.

**Intensity-based allocation** describes a way to allocate carbon credits where the number allocated depends on output levels and the set “allocative baseline”. This means a firm will get more credits if they increase their output (as long as they maintain or decrease their carbon intensity). This method of allocation removes the marginal cost impact of a carbon price.<sup>10</sup>

### **Lack of an allocation cap increases fiscal risk**

The explanatory note points out there will be “*increasingly large fiscal costs over the long term.*”<sup>10</sup> With no allocation cap on the number of credits allocated for free, these costs can increase without limit.

**The lack of a cap on the number of units allocated significantly increases both fiscal risk and policy uncertainty for businesses.**

The lack of an allocation cap weakens the incentive for industry to move to being less carbon-intensive. This is likely to lead to significant emissions increases over time, increasing the number of credits the Government will have to buy to meet international obligations.

In addition, a weak price signals increases the risk that the Government will have to pay compensation for stranded assets in future.

### **Lack of an allocation cap increases policy uncertainty for businesses**

Business needs policy certainty. For this reason it is vital that New Zealand’s ETS has the widest cross-party support possible. In reality, for an allocation plan to endure, it needs the support of the Labour Party as the second largest party in Parliament. Labour has said it will not support intensity-based allocation without a cap.<sup>13</sup> If there is a cap on the number of credits freely allocated, Labour has indicated they may agree to an intensity-based scheme.<sup>13</sup> Introducing a cap will increase the political durability of the ETS, and so increase policy certainty for business.

Recommendation 4:

**I recommend that a cap on the number of units freely allocated be retained.**

## Allocation phase-out rate

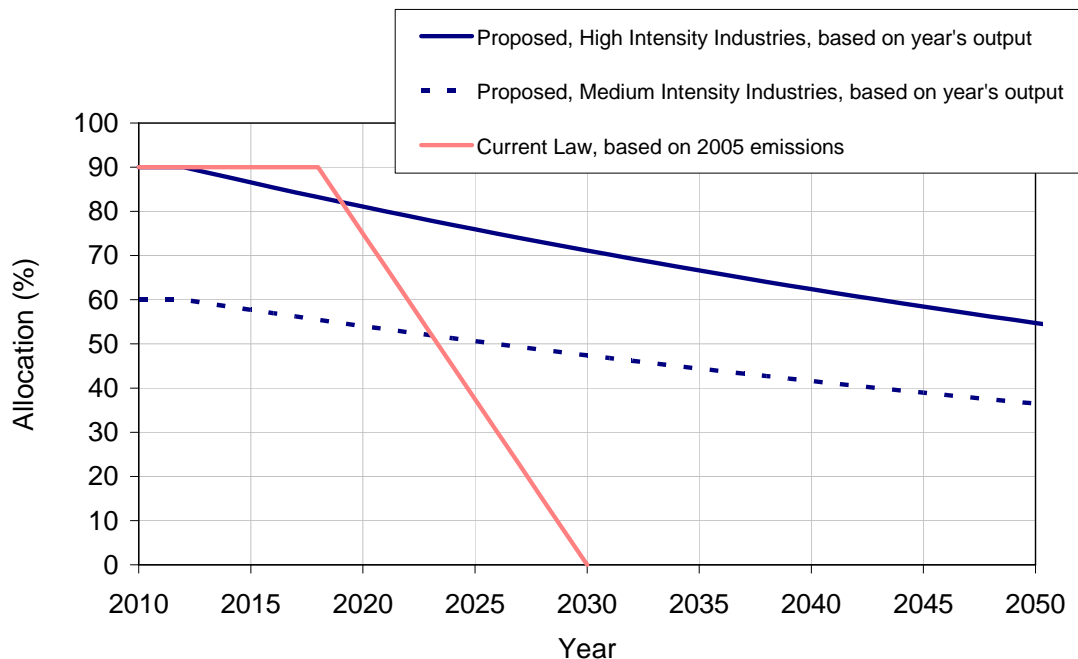
Under the proposed allocation phase-out, the government will never stop giving away carbon credits to industry.

Under the amendments, the phase-out of allocating free carbon credits will be significantly slowed to a decrease of 1.3 percent of the previous year's allocation each year.<sup>14</sup> This means that the annual decrease gets smaller and smaller. Carbon credits will be freely allocated forever.

Under this scheme in 2050 the NZ government will still be paying for 55 percent of emissions from high emission-intensive industries, and 37 percent from medium emission-intensive industries (Figure 1).

This is incompatible with the Government's target to reduce 1990 emissions by 50 percent by 2050.

**Figure 1: The phase-out of allocation in the proposed amendments is slower and more costly over the long term that the current law**



As Treasury analysts point out:

*"there is no information on the implied transition path for firms over the medium-to-long term, particularly given that the proposal is for a temporary period of greater assistance coupled with an ambitious long-term emissions reduction target"*<sup>10</sup>

A slow phase-out rate leads to increased fiscal risk because:

- The incentive to invest in technologies that have low-carbon intensity is severely blunted. Moreover, such slow phase-out can incentivise inefficient and carbon-intensive technologies. This will lead to continuing emissions increases and an increased risk of compensation costs for stranded assets later on.
- The absolute number of carbon credits allocated is likely to increase over time, as emissions may well grow faster than 1.3 percent, and therefore outpace the allocation decreases.<sup>15</sup>
- The price of carbon credits is likely to increase over time as international emissions caps lower and available credits get scarcer<sup>16</sup>.

#### Recommendation 5:

**I recommend any phase-out rate for allocation defined in either legislation or regulations be required to specify the latest year in which allocation of free carbon credits will cease.**

## 2. Agriculture

**Agriculture is not included in the proposed Australia CPRS. There is no rationale for the allocation plan for New Zealand's agriculture sector to be the same as the allocation plans for Australia's industrial processes sector.**

The amendment bill proposes an allocation process for agriculture that the same as that for the industrial processes sector. It is also the same as the proposed allocation to Australia's industrial processes sector.

There is no justification for treating allocation to the agricultural sector the same as industrial processes, either here or in Australia. The impact of the ETS on agriculture is very different to that of industrial process sectors:

- Productive agricultural land can not be shipped offshore. Australian farmers are highly vulnerable to climate change impacts, and have been struggling with a drought for a decade. New Zealand farm production is unlikely to move to Australia. **Carbon credits should not be allocated to prevent an unlikely event.**
- Allocation to protect competitiveness should only be given to firms that will survive in a low-carbon economy. New Zealand's climate, soil quality, and water supply may well place our agriculture in a favourable position in a low-carbon economy. In contrast, New Zealand's industrial processes sector lack any obvious competitive advantage in a low-carbon economy. **The argument to support the agriculture sector is stronger than that for industrial processes because in a low-carbon economy it is likely to be more competitive internationally than the industrial processes sector.**

- The industrial process sector is dominated by large companies, who are better able to ride through a rough transition. If a big industrial company can be profitable in the long-term, they should be able to afford a loss in the short-term. On the other hand, farmers are small businesses, generally in a much less favorable position to cope with the transition. **The agriculture sector may well require greater support than the industrial processes sector to survive through the transition.**

It must be noted though, there is insufficient evidence to justify delaying the entry of agriculture to the Emissions Trading Scheme. Similarly, it is not clear that using an intensity-based allocation system with no cap and a very slow phase-out for agricultural allocation is desirable.

Recommendation 6:

**I recommend a thorough review be undertaken of the agriculture allocation plan including the phase-out rate, because current plans for introducing New Zealand's agricultural sector into the ETS are inadequate for many reasons.**

It could be appropriate for this review to be done by the Finance and Expenditure Select Committee.

### 3. Transparency, accountability and trust

**Transparency is critical for building public trust in the scheme.**

Allocation involves the transfer of a significant amount of money, in the form of carbon credits, from the taxpayer to specific individuals and firms. It is important for transparency and accountability that the number of credits allocated, and to what sector, is publically available. With an intensity-based allocation scheme where the cost to the taxpayer is only known retrospectively, the requirement for transparency is even greater.

An intensity-based allocation system introduces another issue. The number of credits allocated to a particular firm is dependent on its output, which is likely to be deemed commercially sensitive information. However, allocation is a cost to the taxpayer. The detail of allocation information publically available must balance commercial sensitivities against the public's expectation of transparency. Reporting the number of credits allocated by sector reduces commercial sensitivity concerns.

There are two places where information on allocation should be publically available: the emissions unit registry, and the 5 yearly review of ETS operations.

## The Registry for emissions units

The Government keeps track of each ETS participant's carbon credits with the emissions unit Registry. As with income tax, accounts are reconciled annually. This reconciliation includes sorting out any differences between the provisional allocation of credits, done in advance, with the actual entitlement of allocated credits, done retrospectively.

*The Registry works like a bank for carbon credits. All participants in the ETS must have a holding account with the registry, like a bank account. The account records the number of credits they are allocated (deposits), and the number of credits they must surrender to meet their emission obligations (debits).*

The Climate Change Response Act 2002 (CCRA) states that, " *the purpose of the Registry in relation to all units is to facilitate the exchange of information.*"<sup>17</sup> The Registry contains the most up-to-date record of how many credits have been allocated and to whom, individually and collectively. The registry should be the main source of information about allocation.

However, the registry is only required to make public the information specified in Section 27 of the CCRA, and Section 27 only requires the registry to provide the total number of credits *issued* each year. The number of credits issued is not equivalent to the number of credits allocated: the number issued includes those sold by the government and credited for carbon sequestration, as well as credits that have been allocated.

Further, to show allocation is equitable across the economy, we need to know how many are allocated to each sector. To illustrate, the number of credits given to an emissions-intensive industrial process (allocation by intensity, number unknown) will be kept secret but those given to fisheries (credits given on an historical basis) will be known. This is not conducive to building trust in the system.

In my advice to the Emissions Trading Scheme Review select committee earlier this year, I recommended that the Auditor-General report annually on allocation. Requiring the Registry to make public allocation information for each sector yearly would enable to Auditor-General to create an annual independent report on allocation.

### Recommendation 7:

**I recommend that the emissions unit registry be required to make public the number of units allocated for the previous year to each activity, industry or sector.**

This could be achieved by amending Section 27 of the Climate Change Response Act 2002 by adding an additional subsection as follows:

*Section 27 (2) (?) The quantity of New Zealand units allocated free of charge during that year to each eligible activity, industry or sector.*

## Review requirements

The proposed amendments require a report be tabled in Parliament, reviewing the operation of the ETS before the end of 2012, and every 5 years after that.

In respect of allocation, the review will consider what changes are necessary or desirable to the allocation scheme. The review panel will consider the phase-out rate, the level of assistance for eligible activities, emission intensity thresholds, and the determination of trade exposed and eligible industrial activities. This is a very good start for transparency.

The review is required to consider the contribution of the emissions trading scheme towards any targets, and whether any amendment to the Act is required. Why and how many New Zealand credits are allocated to sectors is pertinent to both those questions. These aspects – why and how much - should be explicitly assessed.

This would include, **on a per sector basis**, a retrospective on what **was** allocated in the previous 5 years and the justification for it, as well as the justification for any future allocation. Likewise, the baseline for intensity – based allocation, and the justification for this baseline, should be assessed.

### Recommendation 8:

**I recommend that the Review Panel be required to undertake a comprehensive assessment of the allocation *on a per sector basis* to assess its effectiveness in meeting objectives of the Act. This would include assessing:**

- i) the absolute numbers of credits allocated for free, and**
- ii) the basis for free allocation to industry, sector or activity**
- iii) the determination of the appropriateness of the allocative baseline**

This could be achieved by the following changes to Clause 38 New section 160(5)(j) in the Climate Change Response (Moderated Emissions Trading) Amendment Bill

- (j) what changes to the following aspects of allocation (as applicable) to ~~industry and agriculture under section 82 or 86~~ **individual industry, sectors or activities**[new] are necessary or desirable:
  - i. the absolute numbers of New Zealand units that are allocated for free [new]**
  - ii. the phase-out rate
  - iii. the level of assistance prescribed for eligible activities
  - iv. the determination of the appropriateness of the allocative baseline [new]**
  - v. the emissions intensity thresholds
  - vi. the basis for the allocation to industry, sector or activity [new]**
  - vii. the determination of trade-exposed activities
  - viii. the determination of eligible industrial activities

Allocations given to protect competitiveness must reflect the extent that our overseas competitors are exposed to a carbon price. Now and over the next decade this situation is expected to change rapidly. The 5 years between reviews creates the possibility that industries that are no longer trade-exposed will make windfall profits and/or delay reducing their emissions during this time. Allocations provided to protect competitiveness must be independently assessed more regularly.

Recommendation 9:

**I recommend allocation provided to protect competitiveness is assessed more regularly than the 5 yearly Review Report.**

In addition, the Review process is likely to be a cumbersome method to bring allocation up to date.

Recommendation 10:

**I recommend a mechanism is created allowing changes to the allocation of free credits be fast-tracked.**

## 4. Tree weeds and the ETS

Tree weeds are a significant problem in New Zealand, particularly the South Island high country. Trees weeds, whether planted or wilding, do not respect boundaries and tend to spread onto non-forest land. This increases the cost of controlling tree weeds, including those on Crown land. These feral trees threaten New Zealand's biodiversity, and also the landscape, tourism, fine wool production, and even hydroelectric power generation.



My particular interest in, and concern about, wilding pines developed during the writing of my report *"Change in the high country: Environmental stewardship and tenure review"*.<sup>18</sup> Later in the year, when acting as an independent adviser to the ETS Review Select Committee, I was asked about the likely impact of the ETS on biodiversity.<sup>3</sup> This led to my recommending that it be established in which circumstances, if any, wilding pines would be appropriate for carbon sequestration.<sup>4</sup> This subsequently became one of the Committee's recommendations. Because of the problems caused by wilding pines, the Government needs to make some conscious decisions as to whether or not the spread of wildings across large parts of the country is desirable.

The feral tree problem is serious for economic as well as environmental reasons.

Because tree weeds grow into Kyoto-compliant forests, tree weed management is affected by the ETS. This can happen in two ways: by creating a liability when some tree weeds are

deforested, and by allowing some tree weeds to earn carbon credits. Both of these features create disincentives to control wilding trees.

## Carbon liability for controlling tree weeds

Tree weeds on land that was forest in 1990 (referred to as pre-1990 forest) may attract a carbon liability if these trees are deforested. Under section 184(9)(b) of the Climate Change Response Act 2002, landowners are eligible for an exemption for the carbon liability for clearing pre-1990 tree weeds, as long as the trees were not deliberately planted, i.e. they have "*naturally regenerated*". But planted tree weeds are still tree weeds, and act as a seed source. Seeds from wilding pines in the South Island high country travel up to 30km. Unless planted tree weeds are also removed the problem, and ongoing control expense, of tree weeds will persist.

Recommendation 11:

**I recommend that the Climate Change Response Act 2002 is amended so that pre-1990 tree weeds, which were planted for purposes such as erosion control but are now a problem, can be cleared without incurring a carbon liability.**

This could be achieved by amending the Climate Change Response Act 2002 by deleting sub subsection 184 (9)(b) "has naturally regenerated".

Under current law, carbon liability exemptions for deforesting tree weeds are granted after considering whether the land really is pre-1990 forest land and whether the forest really is of tree weeds. The Amendments propose adding another consideration: the number of tonnes of emissions that will be covered by the exemption.

This implies that exemptions may be denied for large areas of tree weeds. Since the government must pay the carbon liability for any granted exemption, adding this as a consideration reduces immediate fiscal risk. However, this amendment adds a potentially significant barrier to the control of large tracts of wilding trees, generating significant longer-term fiscal risk.

Recommendation 12:

**I recommend that the proposed requirement to report and consider the tonnes of carbon emissions involved when granting carbon liability exemptions for deforesting wilding tree forests be removed.**

This could be done by deleting clauses 44 (3) and 44(5) from the Climate Change Response (Moderated Emissions Trading) Amendment Bill.

## Carbon credits for not controlling tree weeds

Tree weeds on land that was not forest in 1989 (called post-1989 forest) may be eligible to earn carbon credits. This disincentive to control trees weeds should be removed. The problem is significant: over a million hectares is estimated to be affected by wilding trees.<sup>19</sup> How much of this is currently eligible for carbon credits is unknown.<sup>20</sup>

The Resource Management Act 1991 (RMA), the Forests Act (1949), and the Biosecurity Act 1993 contain provisions for the control of tree weeds. The CCRA requires that to be eligible for carbon credits, the land must comply with the RMA and the Forests Act. The proposed amendments (clause 46) add the requirement that the land also “complies with any pest management strategy under the Biosecurity Act 1993”. This is an improvement.

**The tree weed problem has arisen despite the Forests Act, the Resource Management Act, and the Biosecurity Act. Requiring land to comply with these Acts in order to be eligible to earn carbon credits is not sufficient to remove the ability of tree weeds to gain carbon credits.**

However, there is no national pest management strategy for tree weeds. Many regional councils have pest management strategies, but the requirements in relation to tree weeds in those strategies vary considerably. My concern is that this will impact on the ability of pest management strategies to be used to prohibit tree weed forests from earning carbon credits. It is not surprising – regional Pest Management Strategies were not created for this purpose.

As an example, Otago’s Pest Management strategy states that “*all Pinus contorta must be destroyed.*” Therefore, complying with the requirements of the strategy would mean no *P. contorta* forest in Otago would be eligible to earn carbon credits. But other tree weed species in Otago might.

As another example, Canterbury’s Pest Management strategy identifies *P. contorta* as a surveillance plant pest. This makes it an offence to propagate or distribute those organisms. However, the strategy encourages, but does not require, landowners to remove tree weeds. In this case a landowner could do nothing and comply with the Pest Management Strategy, while wilding trees on their land continue to spread. Presumably, they could then claim carbon credits.

The different methods used to identify and control wilding pines under pest management strategies mean that the proposed amendment is unlikely to be effective in removing carbon credit eligibility from tree weeds. The requirement to comply with the Biosecurity Act could be improved by focusing on the identification of tree weed species as being problematic, rather than requiring compliance with a pest management strategy.

Recommendation 13:

**I recommend that the provision to remove the eligibility of problem tree weeds to earn carbon credits be strengthened.**

This could be achieved by deleting the phrase in clause 46 substituted section 188(1)(c)(ii) in the Climate Change Response (Moderated Emissions Trading) Amendment Bill, “complies with any pest management strategy under the Biosecurity Act” and replacing it with “is not identified as a pest, or unwanted organism under the Biosecurity Act 1993”.

## Appendix: List of recommendations

1. I recommend that notification of intention regarding New Zealand units explicitly specify the justification/reasons for any free allocation of carbon credits to any particular activity, industry or sector.

This could be achieved by amending clause 22, new section 70(2) in the Climate Change Response (Moderated Emissions Trading) Amendment Bill by adding a new subsection *“(d) the specific reasons for any allocation of New Zealand units free of charge to any activity, industry or sector.”*

2. I recommend that New Zealand not align its allocation plan with the proposed Australian Carbon Pollution Reduction scheme.
3. I recommend that all references to the proposed Australian Carbon Pollution Reduction Scheme be deleted from the Climate Change Response (Moderated Emissions Trading) Amendment Bill.
4. I recommend that a cap on the number of units freely allocated be retained.
5. I recommend any phase-out rate for allocation defined in either legislation or regulations be required to specify the latest year in which allocation of free carbon credits will cease.
6. I recommend a thorough review be undertaken of the agriculture allocation plan including the phase-out rate, because current plans for introducing New Zealand’s agricultural sector into the ETS are inadequate for many reasons.

It could be appropriate for this review to be done by the Finance and Expenditure Select Committee.

7. I recommend that the emissions unit registry be required to make public the number of units allocated for the previous year to each activity, industry or sector.

This could be achieved by amending Section 27 of the Climate Change Response Act 2002 by adding an additional subsection as follows:

*Section 27 (2) (?) The quantity of New Zealand units allocated free of charge during that year to each eligible activity, industry or sector.*

8. I recommend that the Review Panel be required to undertake a comprehensive assessment of the allocation *on a per sector basis* to assess its effectiveness in meeting objectives of the Act. This would include assessing:
- i) the absolute numbers of credits allocated for free, and
  - ii) the basis for free allocation to industry, sector or activity
  - iii) the determination of the appropriateness of the allocative baseline

This could be achieved by the following changes to Clause 38 New section 160(5)(j) in the Climate Change Response (Moderated Emissions Trading) Amendment Bill

(j) what changes to the following aspects of allocation (as applicable) to ~~industry and agriculture under section 82 or 86~~ individual **industry, sectors or activities[new]** are necessary or desirable:

- i. **the absolute numbers of New Zealand units that are allocated for free [new]**
- ii. the phase-out rate
- iii. the level of assistance prescribed for eligible activities
- iv. **the determination of the appropriateness of the allocative baseline [new]**
- v. the emissions intensity thresholds
- vi. **the basis for the allocation to industry, sector or activity [new]**
- vii. the determination of trade-exposed activities
- viii. the determination of eligible industrial activities

9. I recommend allocation provided to protect competitiveness is assessed more regularly than the 5 yearly Review Report.

10. I recommend a mechanism is created allowing changes to the allocation of free credits be fast-tracked.

11. I recommend that the Climate Change Response Act 2002 is amended so that pre-1990 tree weeds, which were planted for purposes such as erosion control but are now a problem, can be cleared without incurring a carbon liability.

This could be achieved by amending the Climate Change Response Act 2002 by deleting sub subsection 184 (9)(b) "has naturally regenerated".

**12. I recommend that the proposed requirement to report and consider the tonnes of carbon emissions involved when granting carbon liability exemptions for deforesting wilding tree forests be removed.**

This could be done by deleting clauses 44 (3) and 44(5) from the Climate Change Response (Moderated Emissions Trading) Amendment Bill.

**13. I recommend that the provision to remove the eligibility of problem tree weeds to earn carbon credits be strengthened.**

This could be achieved by deleting the phrase in clause 46 substituted section 188(1)(c)(ii) in the Climate Change Response (Moderated Emissions Trading) Amendment Bill, "complies with any pest management strategy under the Biosecurity Act" and replacing it with "is not identified as a pest, or unwanted organism under the Biosecurity Act 1993".

## Endnotes

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- <sup>1</sup> Parliamentary Commissioner for the Environment. 2008. "Advice from Dr Jan Wright on the Climate Change (Emissions Trading and Renewable Preference) Bill". *Text of advice to the Finance and Expenditure Select Committee*. Wellington.  
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- <sup>4</sup> Parliamentary Commissioner for the Environment. 2009. "Impact of the ETS on Indigenous Land Cover". *Text of Advice given to the Emissions Trading Scheme Review Select Committee*. Wellington.  
[www.pce.parliament.nz/\\_\\_data/assets/pdf\\_file/0011/3998/PCE\\_Forestry\\_Advice\\_Text.pdf](http://www.pce.parliament.nz/__data/assets/pdf_file/0011/3998/PCE_Forestry_Advice_Text.pdf)
- <sup>5</sup> Climate Change Response Act 2002 (Section 3).
- <sup>6</sup> Hon. Nick Smith, Minister for Climate Change Issues. *Ministerial Statement to accompany Direction to the Registrar of the New Zealand Emission Unit Registry*. Available online at <http://www.climatechange.govt.nz/emissions-trading-scheme/2009-03-nzeur-direction-attach.html>
- <sup>7</sup> These credits are allocated as *Assigned Amount Units* (AAUs).
- <sup>8</sup> Public Finance Act 1989 (Section 1A)
- <sup>9</sup> Climate Change Leadership Forum (2006). "Preliminary feedback from Climate Change Leadership Forum leakage case studies". *Climate Change Leadership forum report number: 6*.  
[www.climatechange.govt.nz/emissions-trading-scheme/input-and-engagement/climate-change-leadership-forum/2008-06/cluster-b-report.html](http://www.climatechange.govt.nz/emissions-trading-scheme/input-and-engagement/climate-change-leadership-forum/2008-06/cluster-b-report.html) [last accessed 9 October 2009]
- <sup>10</sup> Explanatory Note. Climate Change Response (Moderated Emissions Trading) Amendment Bill.
- <sup>11</sup> Carbon Pollution Reduction Scheme.
- <sup>12</sup> Section 728 in the Bill currently before the United States senate, titled "To create clean energy jobs, promote energy independence, reduce global warming pollution, and transition to a clean energy economy", states:  
"(b) DISQUALIFIED ALLOWANCES.—An international emission allowance may not be held under section 722(d)(3) if it is in the nature of an offset instrument or allowance awarded based on the achievement of greenhouse gas emission reductions or avoidance, or greenhouse gas sequestration, that are not subject to the mandatory absolute tonnage limits referred to in subsection (a)(1)."
- <sup>13</sup> Emissions Trading Scheme Review Committee. 2009. "Review of the Emissions Trading Scheme and related matters". *Report of the Emissions Trading Scheme Review Committee*. August 2009, Wellington: 97-99.
- <sup>14</sup> In the Climate Change Response (Moderated Emissions Trading) Amendment Bill, Clause 22, new sections 82(1)(a)(ii), 82(1)(b)(ii), 85(2)(a)(ii), and 85(2)(b)(ii) all state:

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“in each year after 2012, the level of assistance from the previous year less 1.3 percent...”

<sup>15</sup> Emissions from the industrial process sector grew by 35 percent between 1990 and 2007, giving an average annual growth rate of 2 percent. (source: Ministry for the Environment. 2009. *Greenhouse Gas Inventory 2009*. Wellington. [www.mfe.govt.nz/publications/climate/greenhouse-gas-inventory-2009/html/page4.html](http://www.mfe.govt.nz/publications/climate/greenhouse-gas-inventory-2009/html/page4.html) [last accessed 9 October 2009])

<sup>16</sup> Although there may be a temporary decrease in carbon prices if there is a large increase in the numbers of countries participating in emissions trading.

<sup>17</sup> Climate Change Response Act 2002 (Section 10(3))

<sup>18</sup> Parliamentary Commissioner for the Environment. 2009. *Change in the high country: Environmental stewardship and tenure review* Wellington. [http://www.pce.parliament.nz/work\\_programme/reports\\_by\\_subject/all\\_reports/land\\_use/change\\_in\\_the\\_high\\_country\\_environmental\\_stewardship\\_and\\_tenure\\_review](http://www.pce.parliament.nz/work_programme/reports_by_subject/all_reports/land_use/change_in_the_high_country_environmental_stewardship_and_tenure_review)

<sup>19</sup> Ledgard, N. (Scion). 9 October 2009. Re>> Wilding conifers and the ETS. Email to J. Hendy (Office of the Parliamentary Commissioner for the Environment) from N. Ledgard (Scion).

<sup>20</sup> To be eligible it must be post-1989 forest with greater than 30 percent coverage.