Addendum to the Submission on the

Climate Change Response (Emissions Trading and Other Matters) Amendment Bill

Submission to the Finance and Expenditure Committee

Dr Jan Wright

Parliamentary Commissioner for the Environment

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

Introduction

Climate change is the biggest environmental challenge we face. Over my term as Commissioner I have continued to make submissions on the Emissions Trading Scheme as it has evolved, and acted as an adviser to the ETS Review Select Committee.[1] In my role I take an independent, long term view of the systems and processes which affect New Zealand's environment.

Despite the weaknesses in the current scheme, I continue to believe that an ETS is the right mechanism to price carbon. It possesses the flexibility and potential to drive efficient reductions in greenhouse gas emissions. The ETS, which is the main tool the Government is using to combat climate change, has already been significantly weakened by amendments.

The changes proposed in this Bill will further weaken the ETS.

This is because the carbon market cannot operate without an effective price signal to incentivise changes in behavior. Changes in this Bill mute the price signal by shifting the burden of cost even more from the polluter to the taxpayer.[2] Indeed, by making taxpayers subsidise the cost of pollution indefinitely, the amendments distort the market and limit the incentive to reduce emissions. Thus, they undermine the purpose of an ETS – the economically efficient reduction of greenhouse gas emissions.

Future international agreements are uncertain as the first Kyoto commitment period ends this year. Nevertheless, at Copenhagen New Zealand set a target of a 10-20 percent reduction in greenhouse gas emissions below 1990 levels by 2020.[3] The Government has also committed to a 50 percent reduction in greenhouse gas emissions below 1990 levels by 2050.[4] Even in the absence of a financially binding international agreement, meeting these targets will require emissions reductions within New Zealand or buying credits offshore. If polluters do not pay for this, then the taxpayer must.

The Ministry for the Environment has estimated that the direct cost to the taxpayer of the proposed changes is around $330 million over the next four years. There are two things to note about this figure. First, it is based on a carbon price of $6/tonne. However, at the price carbon was just over a year ago ($19/tonne) this figure would be a billion dollars. Second, the Ministry for the Environment estimate accounts for just the changes proposed in this Bill, not the full cost of all subsidies under the ETS.

Such an approach is locking New Zealand into a high carbon future, weakening incentives for innovation and green growth, and risking New Zealand's clean, green reputation.

This submission focuses on four aspects of the Bill. These are:

1. Extending taxpayer subsidies to big polluters
2. Reviewing the ETS – accountability and transparency
3. Delaying the introduction of agriculture indefinitely
4. Aligning with overseas emissions trading schemes

I am disappointed with the tight time frame that has been imposed on submitters, given the Bill has such far reaching consequences for the country's climate change policy. I would appreciate the opportunity to speak to this submission.

History of carbon pricing in New Zealand[5]

1992

NZ commits to reduce emissions

2002

Climate Change Response Act 2002

Carbon tax proposed

2005

Carbon tax withdrawn

2007

ETS proposed:

- all sectors included by 2013
- allocation subsidies to big polluters until 2025

2008

Amendment Act

- ETS established
- allocation subsidies to big polluters until 2030

2009

Amendment Act

- subsidies to all polluters increased
- entry of agriculture delayed until 2015

2012

Amendment Bill

- subsidies to all polluters continue indefinitely
- entry of agriculture delayed indefinitely

1. Extending taxpayer subsidies to big polluters

Taxpayers already subsidise polluters at considerable cost, in the form of:

- free carbon credits to big polluters (allocation)
- polluters paying for only half their carbon emissions (two-for-one provision)
- a price cap ($25/tonne)

Under the existing Act these subsidies are currently scheduled to be phased out over time.

The proposal to extend these subsidies to big polluters indefinitely is the worst aspect of the Bill. These subsidies undermine the purpose of the ETS, which is to drive emission reductions by putting a price on carbon. Muting the price signal, as the Bill proposes, kills the incentive to cut emissions.

Allocation of free carbon credits

In the ETS, the term 'allocation' is used to describe the Government giving away free carbon credits to particular polluters – free to the polluter, but not the taxpayer.

Under the existing Act, the big polluters currently have 90 percent of their emissions subsidised, but this is to be slowly phased out over time.[6] Even so, by 2050 the big polluters would still be responsible for only half their emissions. I have previously made it clear that this phase out is too slow and much too generous to the most carbon-intensive polluters.

However, the Bill would put the phase out on hold indefinitely, which would in turn effectively lock in the 90 percent allocation subsidy.[7] This makes a farce of our response to climate change.

I note that the ETS Review Panel recommended a faster phase out and a clear end date.[8]

Two-for-one

The two-for-one subsidy means that all polluters are required to only surrender one credit for every two tonnes of emissions. In effect, the taxpayer provides the second credit. Under the current Act this subsidy would be removed at the end of this year. Under the Bill this subsidy would carry on indefinitely.

The price cap

The current Act caps the price of a carbon credit at $25/tonne. Although the international price is considerably less than this, the carbon market is volatile and the price of a credit may well exceed $25/tonne in the near future. When and if this happens, the Government will have to pay the additional cost over $25/tonne.

Like the two-for-one deal this (potential) subsidy was due to be removed at the end of this year but would be extended indefinitely by the Bill.

Combined effect of policies

In the case of big polluters, free allocation means they pay for only ten percent of their emissions. When combined with the two-for-one provision their liability drops to a mere five percent. And, under this Bill these polluters would continue to pay for only five percent of their emissions indefinitely. In such circumstances there is no way New Zealand would reach its legislated target of a 50 percent reduction in emissions by 2050.

1. I recommend that:

a) the existing legislation remains unamended so that the two-for-one provision and the price cap stop at the end of 2012, and,

b) that free allocation stop no later than 2030 (the date originally legislated).

2. Reviewing the ETS – accountability and transparency

The current Act requires that an appointed panel review the ETS every five years. Such reviews provide a mechanism for a level of engagement, accountability and transparency that is fundamental to good governance.

This Bill removes the requirement for such reviews. Instead the decision to review (or not) is left entirely at the discretion of the Minister.

The Government has stated that it intends to review the ETS in 2015. However, it seems contradictory that the proposed changes remove any legal obligation on the Government to do so.[10]

Weakening of review provisions

The following is a brief summary of the current review provisions in the Act and those proposed in the Bill:

- Under the Act a review must be done every five years. The proposal removes the certainty provided by the current review cycle. Instead the Minister is able to instigate a review at any time (or not at all).

- Under the Act a review must be completed within 12 months. Under the proposal the Minister sets the date the review should be completed – should he/she wish to undertake a review.

- Under the Act the Minister must consider certain matters. Under the proposal the review will be by 'any method' considered appropriate by the Minister. This means that factors such as New Zealand's international obligations, potential linkages to overseas trading schemes and whether an activity is covered by the ETS (or not) do not have to be considered.[11]

- Under the Act the Minister must appoint a panel to conduct reviews. Under the proposal the Minister does not need to appoint a panel. The Minister may, for example, appoint a government agency to conduct a review. This would mean that the review would not be done independently.

These changes leave reviews entirely at the Minister's discretion and provide no guiding principles for exercising that discretion.[12]

2. I recommend that:

- **the current legislated review provisions are retained.**

3. Delaying the introduction of agriculture indefinitely

Agriculture is currently set to enter the ETS in 2015. The Bill puts this entry on hold indefinitely. The agricultural sector is responsible for around half of New Zealand's greenhouse gas emissions mainly in the form of methane and nitrous oxide.

Backtracking on agriculture sends a negative signal to the international community. It also brings into question our commitment to greenhouse gas reductions, which in turn undermines our clean, green image. Indeed, Prime Minister John Key has previously warned farmers that consumers may not buy our products if New Zealand is not living up to environmental standards: "*As a trading nation we simply cannot afford to get it wrong.*"[13]

There are also advantages to agriculture entering the ETS. New Zealand's agricultural science is advanced by international standards and is in a good position to produce innovative emission-reducing technologies. Moving to a low-emissions agricultural model would further enhance our environmental credentials in the international marketplace.

At the domestic level some actions that reduce greenhouse gas emissions are also likely to improve water quality.

However, there is an argument for protecting our agricultural sector from the full cost of their emissions for a time. Many of our farms are small, family owned businesses that will require transition time to remain financially viable. For a number of reasons there is a much stronger argument for giving free carbon credits to agriculture than there is for other industries.

3. I recommend that:

- **agriculture is brought into the ETS by 2015 as is currently legislated.**

4. Aligning with overseas emissions trading schemes

At the time the ETS was created it was one of the first greenhouse gas emissions trading systems. Indeed, one of my early recommendations was that our legislation should not align with Australia as their system was still being developed at the time and the form that it would take was unclear.

However, we are now just one of many jurisdictions that have or are implementing emissions trading schemes. These include:

- The EU covering 30 countries
- 16 US states
- 4 Canadian provinces
- Australia
- South Korea
- China
- Japan[14]

Emissions trading schemes differ in design and implementation detail. However, they are all based on the trading of carbon credits.

The EU, Australia, South Korea and others have restricted the types of carbon credits that can be traded.[15] There are at least two reasons for doing this.

First, some carbon credits are more credible than others. There are differences in monitoring, measurement, and verification between different countries and systems. Some types of foreign credits do not result in actual emission reductions. Such credibility is critical to the environmental integrity of an emissions trading scheme.

Second, there is a balance to strike between allowing some international trade in carbon credits (so the least cost carbon reductions can occur worldwide) and making sure that investment also contributes to creating a domestic low carbon economy[16]. New Zealand credits (NZUs) drive green growth, energy efficiency and forestry within New Zealand.

While New Zealand has some restrictions on the types of credits, these will need to be tightened before being able to link to other schemes. In Australia, for example, a firm can only meet up to 50 percent of its emissions by purchasing credits offshore, and there are further restrictions on types of credits.[17]

4. I recommend that:

- **a firm can only meet up to 50 percent of its emissions by purchasing credits offshore.**

Conclusion

It is critical to stay focused on the purpose of the ETS. It is the main mechanism by which successive governments have chosen to address climate change. While previous legislation has weakened the scheme, the changes proposed in this Bill render it almost toothless.

Changes such as locking in large subsidies to polluters and making the review of these subsidies optional means it is unlikely that the ETS can significantly reduce New Zealand's greenhouse gas emissions. We will certainly not reach the Government's target of a 50 percent reduction in emissions by 2050.

The Cabinet paper on the Bill states that a driving reason for the amendments is to provide "more flexibility and mitigating short term costs for business whilst ensuring clear long term price signals that encourage a smooth transition to a low carbon economy."[18]

However, this Bill signals that there will be little direct cost for emitting carbon dioxide even in the long-term. And without a direct cost, there will be no transition to a low carbon economy, smooth or otherwise. Indeed, major polluters will still be paying for just five percent of their emissions in 2050.

Climate change is the biggest environmental issue of our time. This clean, green country needs to take it a lot more seriously.

Endnotes

1 Available in hard copy or for downloading from the website www.pce.parliament.nz
"Advice on the ETS Review 2009", August 2009.
"Submission on the Climate Change Response (Moderated Emissions Trading) Amendment Bill", October 2009.
"Submission on Industrial Allocation Regulations under the ETS", February 2010.
Parliamentary Commissioner for the Environment, "Submission on Forestry Regulations under the ETS", March 2010.

2 Because allocation is done on an intensity basis it affects the marginal price.

3 Conditional on a number of international milestones being achieved.

4 Climate Change Response (2050 Emissions Target) Notice 2011.

5 Note: 'Big polluters' are defined as emissions-intensive trade-exposed industries.

6 The amount of allocation firms are eligible to receive is based on their emissions intensity. If a firm is deemed to be high intensity (i.e. they emit at least 1600 tonnes of CO_2eq per $1million revenue) they receive 90 percent of the allocative baseline. If they are deemed to be moderate intensity (i.e. they emit at least 800 tonnes of CO_2eq per $1 million revenue) they receive 60 percent of the allocative baseline. If a firm's emission intensity does not reach the moderate intensity threshold, they are not eligible to receive any allocation.

7 Clause 36 of the Climate Change Response (Emissions Trading and Other Matters) Amendment Bill suspends the phase-out rates for allocation until participants face full surrender obligations. However, Clause 28 of the Bill states that participants are only liable to surrender one unit for each two whole tonnes of emissions and there is no stipulated date for when participants will face full obligations.

8 The ETS Advisory Panel recommended straight line phase out of allocations 1.3 per cent per annum rather than 1.3 percent of previous year's allocation. It also recommended a clear fixed end date.

9 $260 million is the cost of extension of the two-for-one provision from 2012/2013 to 2015/2016. Data provided by MfE. September 2012.

10 “Agree that the next review of the ETS take place in 2015 and that it will specifically cover agriculture's entry to the ETS and the extension of the one-for-two and fixed price option” Emissions Trading Scheme Review 2012 – final decisions on amendments to the Climate Change Response Act 2002 p.3

11 Section 160(5)(b) international obligations, (g) linkages to overseas ETS, (i) add or remove activities from the ETS among a detailed list of factors that the Minister must currently consider in a review.

12 Clause 63 replaces section 160 with a revised process under which the Minister may initiate a review of the ETS.

13 ‘PM tells farmers to accept $3K ETS cost, stop moaning’. NZ Herald November 19 2009.

14 International examples of emissions trading MfE website accessed September 2012.

15 EC press release FAQ: Linking the Australian and European Union emissions trading systems Brussels, 28 August 2012.

16 The lack of restriction on using international carbon credits in the ETS has meant that New Zealand emitters have recently brought cheap credits from overseas instead of New Zealand carbon credits – referred to as NZUs. ‘ETS loophole to halve cost for NZ’s biggest carbon emitters. Scoop Friday, 10 August 2012.

17 ‘To facilitate the negotiation of a full link, the Australian Government is … introducing an additional sub-limit on the use of Kyoto Protocol eligible international units such that firms will be able to use these units to meet up to 12.5 per cent of their annual liabilities within the 50 per cent overall limit on the use of eligible international units. This limit will ensure that the link operates effectively and provides long term price certainty for businesses investing in low emissions technologies.’ EC press release FAQ: Linking the Australian and European Union emissions trading systems Brussels, 28 August 2012.

18 Cabinet paper. Emissions Trading Scheme Review 2012 – final decisions on amendments to the Climate Change Response Act 2002 p.1