

Regulatory Impact Statement

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EXECUTIVE SUMMARY

Under the New Zealand Emissions Trading Scheme (NZ ETS), different sectors start to have obligations under the scheme at different times. The forestry sector has an obligation to surrender units in respect of relevant emissions from 1 January 2008. Under the current legislation, further sectors will “enter” the scheme as follows:

- The stationary energy and industrial processes sectors (SEIP sector) will have obligations to surrender units in respect of their emissions from 1 January 2010.
- Participants in the liquid fossil fuels sector will have obligations to surrender units in respect of emissions from 1 January 2011.
- Participants in the waste, agriculture and synthetic gases sectors will have obligations to surrender units in respect of emissions from 1 January 2013.

A sector is said to have “entered” the NZ ETS from a certain date where it has obligations to surrender units in respect of emissions from that date.

Given that the forestry sector has already entered the NZ ETS, there are a number of implementation dates that are rapidly approaching – for example in respect of the forestry allocation plan. If the scheme is implemented under the current design, it will make it very difficult to make the changes that the government may want to make following its review.

Accordingly, it is proposed that the Climate Change Response Act 2002 (CCRA) will be amended urgently to delay certain deadlines in the CCRA by a specified period of time. In particular, it is proposed amend the date for first notification of deforestation of pre-1990 land from 31 January 2009 to 31 January 2010, and amend the first surrender deadline for pre-1990 land from 30 April 2010 to 30 April 2011. It is also proposed to remove the 30 June 2009 due date for the “less than 50ha” exemption applications (and replace it with a date to be specified in regulations or public notice), and amend the CCRA to allow for the delay or revocation of the draft Forestry Allocation Plan.

The main impact of the proposed amendments to the CCRA is that there will be some uncertainty regarding the policy for treatment of pre-1990 forest land under the NZ ETS. Any change to existing rules brings an element of confusion. However, the uncertainty is mitigated by replacing existing dates with clearly specified new dates. Accordingly, the risks associated with this delay are considered to be low.

ADEQUACY STATEMENT

The Regulatory Impact Analysis Team (RIAT) has not been provided with sufficient time to consider this proposal, or even confirm whether it meets the significance criteria and therefore requires assessment by RIAT. This carries risks of partial/incomplete analysis and resulting unintended effects

STATUS QUO AND PROBLEM

Outline of current situation

The NZ ETS came into force on 26 September 2008.¹ 'Emissions trading' is a market-based approach for achieving environmental objectives where emission units are traded between participants. In effect, those emitting greenhouse gases have to pay for increases in emissions and are rewarded for decreases. This encourages emissions reductions.

The NZ ETS covers emissions of the following six greenhouse gases: carbon dioxide (CO₂), methane (CH₄), nitrous oxide (N₂O), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs), and sulphur hexafluoride (SF₆). These are the greenhouse gases covered by the Kyoto Protocol.

The NZ ETS covers the following sectors of the economy: forestry, liquid fossil fuels (transport), stationary energy, industrial processes, synthetic gases, agriculture and waste.

In respect of each sector covered by the NZ ETS, there are a number of 'participants'. Each participant must calculate the emissions from their activities and surrender to the government one emission unit for each tonne of greenhouse gas emissions for which they are responsible. There are various types of units that participants can use to meet their obligations under the emissions trading scheme.

The primary unit of trade for the New Zealand emissions trading scheme is the New Zealand unit (NZU). The NZU is a unit issued and allocated by the government under the scheme. One NZU corresponds to one tonne of carbon dioxide equivalent emissions. Participants can use NZUs to meet their obligations under the emissions trading scheme by transferring them to a surrender account.

In addition, participants can use most types of Kyoto emission units for compliance. As with NZUs, this is done by transferring the Kyoto emission units to a surrender account. Kyoto emission units are units established under the rules of the Kyoto Protocol.

The CCRA identifies who is required to be a participant under the NZ ETS. For example, in the transport sector, importers of liquid fossil fuels are required to be participants. In general, the 'point of obligation' is established

¹ Except for the sections of the Act relating to GST which came into force on 1 January 2009.

at a high level in the supply chain so that there are relatively few participants in each sector. Householders are not participants under the NZ ETS.

Under the NZ ETS, different sectors start to have obligations under the scheme at different times. The forestry sector has an obligation to surrender units in respect of relevant emissions from 1 January 2008. Under the current legislation, further sectors will “enter” the scheme as follows:

- The stationary energy and industrial processes sectors will have obligations to surrender units in respect of their emissions from 1 January 2010.
- Participants in the liquid fossil fuels sector will have obligations to surrender units in respect of emissions from 1 January 2011.
- Participants in the waste, agriculture and synthetic gases sectors will have obligations to surrender units in respect of emissions from 1 January 2013.

A sector is said to have “entered” the NZ ETS from a certain date where it has obligations to surrender units in respect of emissions from that date.²

As well as imposing an obligation on participants whose activities are covered by the scheme, the NZ ETS provides for ‘allocation’ of units to certain persons. Units are allocated by the government. Allocation is provided to land owners of pre-1990 forest land, to fishing vessel operators, to trade-exposed industry and to participants in the agriculture sector.

In the case of pre-1990 forest land, the purpose of allocation is to compensate land owners for the loss in value of their land as a result of the costs imposed by the NZ ETS. A similar equity rationale applies in the case of allocation to fishing vessel operators. In respect of other sectors, the purpose of allocation is to avoid economic regrets (that is, loss of economic capacity that would not have occurred if our competitors had adopted emissions pricing in the medium term). The detail of how units are to be allocated to these persons will be set out in the relevant ‘allocation plan’ for that sector. No allocation plans have yet been finalised.

In respect of pre-1990 forest land, consideration is being given to the possibility of introducing ‘offsetting’ or another flexibility mechanism. This would affect the manner in which emissions from pre-1990 forest land are required to be accounted for. If a flexibility mechanism was introduced, this could have implications for the compensation that is to be provided under the allocation plans.

However, under the CCRA as currently drafted, the Minister for Climate Change Issues has a duty to publish a Final Allocation Plan in respect of pre-1990 forest land before 30 June 2009. Exemptions from the pre-1990 forest land deforestation obligations have a legislated closing date of 30 June 2009.

The current timing in the CCRA creates a problem because it is not sensible to progress work on the Final Allocation Plan for pre-1990 forest land given

² A sector may have obligations to report on its emissions (but not surrender units) prior to its “entry” date.

that introduction of offsetting or another flexibility regime for pre-1990 forests may require a revision of the Forestry Allocation Plan and reconsideration of the exemption rules.

In order to comply with the legislation, the government would have to publish a Final Allocation Plan that is likely to be inconsistent with the new policy it wishes to develop. This would leave the government in a position where it later introduces amending legislation that alters the basis on which allocation is made. This would create unnecessary confusion within the forestry sector. Continuing with the existing allocation would also come at a significant fiscal cost to the Crown if the allocation of free NZ Units proceeded at the level provided (the existing draft Forestry Allocation Plan provides for the free allocation of 55 million NZ Units at a total fiscal cost of \$1.375 billion³), as well as introducing a new policy enabling greater flexibility for pre-1990 forest land.

OBJECTIVES

The objective of the proposal is to make the minimum changes to the CCRA necessary to allow certain elements of the NZ ETS for pre-1990 forest land to be reviewed and new policy to be developed, as well as providing for smooth implementation of other pre-1990 forest land provisions in the NZ ETS.

ALTERNATIVE OPTIONS

The alternative option is to not pass any amending legislation and let the 30 June 2009 date lapse. It is possible that the date could be amended retrospectively. However this course of action carries with it a risk of legal challenge.

In addition to the legal risk, not passing amending legislation at this time will create significant confusion for forest owners who may be contemplating applying for either an exemption or allocation, particularly as the basis for allocation or obtaining an exemption may change substantially in the future.

PREFERRED OPTION

The preferred option is to amend the pre-1990 forest land provisions of the CCRA as follows:

- a. Remove the 30 June 2009 due date for the “less than 50ha” exemption applications, and replace this deadline with a date to be specified in regulations or public notice.
- b. Amend the CCRA to allow for the delay or revocation of the draft Forestry Allocation Plan while the Government considers offsetting.
- c. Amend the date for the first notification of deforestation for pre-1990 forest land to 31 January 2010 (currently 31 January 2009).

³ Based on carbon price of \$25/tonne.

- d. Amend the first surrender deadline for pre-1990 land to 30 April 2011 (currently 30 April 2010).

These amendments are favoured because the government has indicated that it wants to consider greater flexibility for pre-1990 forests in the ETS, including offsetting. Offsetting is likely to require a revision to the draft Forestry Allocation Plan and reconsideration of the exemption rules. The Minister for Climate Change Issues has a duty to publish a Final Allocation Plan before 30 June 2009 under the Act. An urgent amendment to the Act is therefore required to create the space for the Government to consider offsetting and its implications without having to proceed with the current draft Forestry Allocation Plan.

The purpose of the amendments is to create a delay so as to allow policy to be developed and implemented. Any change to existing rules brings an element of confusion. However, the uncertainty is mitigated by replacing existing dates with clearly specified new dates. Accordingly, the risks associated with this delay are considered to be low. The risks associated with any policy that is ultimately developed and implemented (during the delay created by the current proposals) are not considered in this impact statement.

The proposed amendments to the CCRA in respect of pre-1990 forest land would not affect any other existing rules (aside from those contained currently in the CCRA and which are being amended as described above).

IMPLEMENTATION AND REVIEW

It will be important to inform the forestry sector of the changes to compliance dates for pre-1990 forest land. Plans are in place to undertake these communications.

CONSULTATION

A draft of this Regulatory Impact Statement was circulated to the following departments for comment: the Treasury, the Ministry for Agriculture and Forestry, the Ministry of Economic Development, the Ministry of Foreign Affairs and Trade, the Ministry of Transport, the Department of Prime Minister and Cabinet and Te Puni Kokiri. The Ministry of Agriculture and Forestry provided comments which were incorporated into the Statement.

Stakeholders were not consulted due to the high level of sensitivity associated with the proposed changes to the CCRA. However, a number of relevant observations were made in the course of oral submissions recently heard by the Emissions Trading Scheme Review Committee. Many submitters supported reviewing existing policy settings in the NZ ETS – particularly with regard to allocation and pre-1990 forestry.