



Ministry for the
Environment
Manatū Mō Te Taiao

PROACTIVE RELEASE COVERSHEET

Minister	Hon James Shaw	Portfolio	Climate Change
Name of package	Climate Change Response (Late Payment Penalties and Industrial Allocation) Amendment Bill – proactive release of Cabinet materials	Date to be published	18 October 2023

List of documents that have been proactively released

Date	Title	Author
11 May 2023	2023 Updated Regulatory Impact Statement: Reform of industrial allocation policy in the NZ ETS to address current over-allocation	Ministry for the Environment
12 May 2023	Cabinet paper: Late Payment Penalties and Industrial Allocation Amendment Bill – Further policy decisions	Office of the Minister of Climate Change
18 May 2023	Cabinet Economic Development Committee: Late Payment Penalties and Industrial Allocation Amendment Bill: Further Policy Decisions [DEV-23-MIN-0087]	Cabinet Office
25 May 2023	Cabinet paper: Late Payment Penalties and Industrial Allocation Amendment Bill – Minor policy approval	Office of the Minister of Climate Change
29 May 2023	Cabinet: Late Payment Penalties and Industrial Allocation Amendment Bill – Minor policy approval [CAB-23-MIN-0201]	Cabinet Office
3 August 2023	Cabinet paper: Further policy proposals to amend the Climate Change Response (Late Payment Penalties and Industrial Allocation) Amendment Bill	Office of the Minister of Climate Change
7 August 2023	Cabinet: Climate Change Response (Late Payment Penalties and Industrial Allocation) Amendment Bill: Further Policy Proposals [CAB-23-MIN-0353]	Cabinet Office

Policy and Privacy

In-Confidence

Office of the Minister of Climate Change

Chair, Cabinet Economic Development Committee

Late Payment Penalties and Industrial Allocation Amendment Bill – Further policy decisions

Proposal

- 1 I seek agreement to policy changes for parts of the Climate Change Response (Late Payment Penalties and Industrial Allocation) Amendment Bill (the Bill).

Relation to government priorities

- 2 The Government declared a climate change emergency on 2 December 2020. The Cabinet Business Committee (CBC) agreed that climate change “demands a sufficiently ambitious, urgent, and coordinated response across government to meet the scale and complexity of the challenge” [CBC-20-MIN-0097 refers].
- 3 Enabling a just transition to a low-emissions, climate resilient future is a Government priority. CBC declared its intention to “put the climate at the centre of government decision-making” [CBC-20-MIN-0097 refers].
- 4 The proposals in this paper relate to the Cooperation Agreement between the Labour and Green Parties. Achieving the purpose and goals of the 2019 zero carbon amendments to the CCRA is an agreed area of cooperation.
- 5 Reviewing industrial allocation and addressing over-allocation is action 5.4.1 in the Government’s first emissions reduction plan. The emissions reduction plan, outlining policies and strategies to meet New Zealand’s first three emissions budgets was approved by Cabinet and made public in May 2022.

Executive Summary

- 6 A Bill amending the Climate Change Response Act 2002 (the Act) is at Select Committee stage. This paper seeks Cabinet approval to policy changes to inform the departmental report on this Bill to the Environment Select Committee (the Committee).
- 7 The Bill has two parts. The first relates to penalties to be applied to small foresters who fail to carry out certain prescribed activities. No changes are sought to this part. The second part updates industrial allocation under the New Zealand Emissions Trading Scheme (NZ ETS).

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- 8 The changes to industrial allocation in the NZ ETS seek to update decade-old industrial allocation settings that have resulted in some emitting firms receiving more emissions units than needed. The Bill proposes to enable updates to allocative baselines which are expected to deal with the majority of estimated overallocation. I am not recommending any changes to this proposal.
- 9 The Bill changes the eligibility requirements for industrial allocation. Many submitters, including the Climate Change Commission, the Parliamentary Commissioner for the Environment and other climate experts and non-governmental organisations have expressed concern about that change.
- 10 The primary concern is that the Bill would enable increases in eligibility for, and the volume of, industrial allocation. These submitters argue that this is contrary to New Zealand's broader climate change goals.
- 11 Submitters who receive allocations, or represent those who do, hold a different view. Their view is that cost competitiveness would be at risk from increasing emission costs.
- 12 The purpose of the Act includes providing for the operation of an NZ ETS that supports and encourages global efforts to reduce greenhouse gas emissions by helping New Zealand to meet its international obligations and domestic targets and budget.
- 13 To better balance the need to mitigate leakage with NZ ETS objectives, I seek approval to change the Bill so that:
 - 13.1 Existing eligible activities are not retested for eligibility and no change is made to eligibility thresholds currently in the Act.
 - 13.2 The eligibility tests for industrial allocation are unchanged from those currently in the Act, except for allowing the use of forecast data.¹
- 14 These changes may increase the risk that New Zealand firms reduce production or close because of emissions pricing, compared with the proposals in the Bill. Comparatively fewer firms could be eligible for allocation than if the current provisions in the Bill were passed.
- 15 Out of 26 eligible activities, 12 are classified as 'moderately emissions intensive'. Under my new proposal, these activities will stay at this classification rather than shift up a classification or potentially become ineligible.²
- 16 There are programmes to manage the transition of firms and communities to the low emissions economy. For example, the Government supports firms to decarbonise and reduce emissions costs through the Government Investment

¹ By forecast data, we mean forecast emissions, production and revenue data to inform industrial allocation eligibility tests and settings.

² The following activities are currently classed as moderately emissions intensive: protein meal, reconstituted wood panels, glass containers, lactose, fresh tomatoes, fresh capsicums, fresh cucumbers, ethanol, tissue paper, gelatine, whey powder, clay bricks and field tiles. In 2021, just under 60 firms received industrial allocation for carrying out these activities: [Allocation decisions | EPA](#).

in Decarbonising Industry Fund (GIDI), NZ Green Investment Finance and other measures. Industry transformation plans are in place or under development.

- 17 My proposed second set of changes to the Bill adds to the list of emissions sources that are counted for industrial allocation settings. I seek Cabinet agreement to include combusting used tyres for energy and consuming CO₂ as a feedstock as additional emissions sources. This will support industrial allocation to mitigate the risk of emissions leakage and remove a disincentive for some decarbonisation investments.
- 18 Subject to Cabinet decisions, these recommendations will be included in the departmental report to the Committee for inclusion in the revision-tracked version of the Bill or via Supplementary Order Paper (dependent on timing).
- 19 Finally, the Bill requires the Electricity Authority (EA) to recommend a value for the electricity allocation factor (EAF) to the Minister of Climate Change by the end of July each year. For clarity, officials will recommend to the Committee, via the departmental report, that this requirement commences in 2024. This is not a change to government policy.

Background

- 20 Industrial allocation reduces the risk that the production of our most trade exposed and emissions intensive firms shifts offshore because of emissions pricing. Firms carrying out eligible activities receive emission units from the Government based on production.
- 21 Eligibility thresholds test whether an activity should be eligible for industrial allocation. They also test what the level of assistance should be. This is dependent on which emissions intensity category an activity falls into (by assessing the amount of emissions an activity generates relative to its revenue).
- 22 Allocative baselines are also used to determine how much industrial allocation an activity should receive (by calculating emissions produced per unit of production). See formula below.

Industrial allocation = level of assistance x allocative baseline x tonnes of product

- 23 The existing thresholds are 800 t CO₂-e³/ \$1 million revenue and 1,600 t CO₂-e/ \$1 million revenue. Activities with an emissions intensity above 1,600 t CO₂-e/ \$1 million revenue were classified as highly emissions-intensive. Those falling between the two thresholds were classified as moderately emissions-intensive. These thresholds were set in 2009 and assumed an emissions price of \$25 per t CO₂-e.
- 24 The moderately emissions-intensive threshold corresponded to an activity that had emissions costs of more than \$20,000 per \$1 million revenue (2% of revenue). The highly emissions-intensive threshold corresponded to an

³ CO₂-e or carbon dioxide equivalent is a metric that converts all greenhouse gases into an equivalent amount of carbon dioxide to account for their different global warming potentials.

activity that had emissions costs of more than \$40,000 per \$1 million revenue (4% of revenue).

- 25 Current levels of assistance and allocative baselines are set based on decade old data resulting in some emitting firms receiving overallocation.
- 26 In July 2022, Cabinet agreed to various policy decisions to address this overallocation and other updates to industrial allocation in the NZ ETS CAB-22-MIN-0536 refers]. The Bill to enable these updates was introduced into the House in December 2022. The Bill had its first reading and was referred to the Committee on 21 February 2023. Analysis of 110 submissions to the Committee is underway.

Analysis

- 27 Cabinet made those decisions based on evidence that firms in some activities are receiving more industrial allocation than needed. The decisions, which were informed by public consultation, included amending the Act to allow the Minister to:
 - 27.1 update allocative baselines (no change proposed)
 - 27.2 retest eligibility, using update eligibility thresholds to reflect a more recent carbon price (see **Table 1** for implications);
 - 27.3 enable additional activities to seek eligibility using the revised thresholds;
 - 27.3.1 but also to increase the rigour of the eligibility test by requiring the additional criteria outlined in section 84C(3) of the Act to be considered; and
 - 27.3.2 forecast data can be used for the tests and determining allocative baselines where firms do not have operational data; and
 - 27.3.3 the level of assistance be set in line with that of moderately emissions-intensive activities where eligibility is initially derived from forecast data.⁴
- 28 Section 84C(3) of the Act outlines that the Minister must consider:
 - 28.1 any targets or budgets set for reducing emissions of greenhouse gases;
 - 28.2 New Zealand's nationally determined contributions under the Paris Agreement;
 - 28.3 the level of risk of emissions leakage;

⁴ This was when Cabinet also agreed to introduce the Bill.

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- 28.4 the risk that the value of the allocation for the activity will exceed the cost of meeting NZ ETS obligations in relation to the activity;
- 28.5 other sources of supply into the NZ ETS;
- 28.6 the availability of low-emission technologies related to the activity;
- 28.7 international climate change obligations;
- 28.8 the proper functioning of the NZ ETS;
- 28.9 the cost to the taxpayer of providing allocations for the activity; and
- 28.10 any other matters that the Minister considers relevant.
- 29 At this time, I indicated that, the approach to eligibility for additional activities may need refinement following introduction of the Bill given some of the details of this proposal were not publicly consulted on [CAB-22-MIN-0536 refers].
- 30 I also asked that the Committee pay particular attention to proposed eligibility settings which could increase eligibility for industrial allocation.

Table 1: Methodology to update eligibility thresholds

Emissions intensity category	Threshold conversion methodology	New threshold (based on a carbon price of \$68) ⁵
Moderately emissions intensive	$800 * \frac{25}{\text{new emissions price}}$	296 t CO ₂ -e/\$1 million revenue
Highly emissions intensive	$1,600 * \frac{25}{\text{new emissions price}}$	591 t CO ₂ -e/\$1 million revenue

- 31 My previous advice to Cabinet acknowledged the fiscal risks of proposals regarding eligibility but not the difficulty reconciling the policy objective to mitigate the risk of emissions leakage with the overall objectives of the NZ ETS. These trade-offs are summarised in **Table 2**.
- 32 Cabinet also agreed to, and the Bill proposes, technical amendments to the Act. These will enable updates to allocative baselines based on previously submitted data. They will also enable the Ministry for Environment and Climate Change Commission to have easier access to data submitted in industrial allocation applications; and setting up a new electricity allocation factor. I am not seeking changes to these proposals.

⁵ The price of carbon is \$67.63 for setting 2023 levies outline in the Climate Change (Synthetic Greenhouse Gas Levies) Regulations.

Table 2: Key trade-offs of policy objectives for eligibility proposals in the Bill versus this paper

	Supports NZ ETS objectives	Mitigates emissions leakage
<i>Proposals currently in the Bill</i>		
<ul style="list-style-type: none"> - Retest eligibility for existing activities, using updated eligibility thresholds to reflect a more recent carbon price. - Enable additional activities to seek eligibility using updated thresholds and following consideration of additional criteria in the Act. 	<ul style="list-style-type: none"> - Would not support as would lead to increases in industrial allocation from eligibility tests. This would lead to reduction in auction volume giving govt less flexibility to influence the NZ ETS price signal. This would also shift decarbonisation costs to other parts of the economy. - Removes a disincentive for some activities considering decarbonisation where amendments are needed to relevant regulations for continued industrial allocation. 	<ul style="list-style-type: none"> - Does this by updating eligibility decisions to account for potential increased risk of leakage due to increased emissions costs (from increase carbon price). - Could do this for activities that exist in NZ but haven't been eligible for industrial allocation, or new investments in new activities and meet updated thresholds.
<i>My proposed changes in this paper</i>		
<ul style="list-style-type: none"> - Do not retest eligibility for existing activities (but still enable reviews and updates to allocative baselines to reflect changes in emissions). - Retain the eligibility thresholds currently in the Act. - Continue allowing additional activities to seek eligibility using existing thresholds (no need to consider additional criteria in the Act). 	<ul style="list-style-type: none"> - Supports by largely retaining industrial allocation at current levels based on current eligibility. - Removes a disincentive for some activities considering decarbonisation but where amendments are needed to regulations for continued industrial allocation. 	<ul style="list-style-type: none"> - Retains current emissions intensity classification but does not account for potential increased risk of leakage due to increased emissions costs (from increase carbon price). - Could do this for activities that exist in NZ but haven't been eligible for industrial allocation, or new investments in new activities and meet existing thresholds.

Submitters have concerns with the eligibility settings proposed in the Bill

- 33 The approaches to testing eligibility for existing eligible activities and additional activities are of great concern for many submitters including the Climate Change Commission, the Parliamentary Commissioner for the Environment and other climate experts and non-government organisations.
- 34 These proposals are of concern because they could lead to increases in the eligibility for, and volume of, industrial allocation. These submitters argue that this is contrary to New Zealand's broader climate change goals (see paragraphs 43-45) and that the actual risk of emissions leakage has changed in the past decade with many other jurisdictions having Nationally Determined Contributions under the Paris Agreement and targets for net zero by 2050.
- 35 The proposals are, however, supported by industry and relevant representative organisations such as Business New Zealand.
- 36 The most contentious change for submitters opposed to the eligibility changes in the Bill is the updating of eligibility thresholds.

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- 37 When the existing thresholds were set in 2010, they aligned with emissions costs of 2% and 4% per \$million of revenue because the emission unit price was \$25 at the time. Retaining the existing eligibility thresholds would have meant an activity would only be deemed eligible if its emissions costs were 6% or 12% per \$million of revenue.
- 38 My advice to Cabinet noted a concern that retesting eligibility using existing thresholds would result in a significant change in the definition of moderately or highly emissions intensive and increase the risk of leakage.
- 39 The Bill reflects Cabinet's decision to adjust eligibility thresholds with a recent carbon price. This would retain alignment with the original thresholds (2% and 4% cost exposure). This could result in moderately emissions intensive activities being reclassified as highly emissions intensive if those activities have not made significant emissions reductions.⁶
- 40 The Act currently allows firms in additional activities to seek eligibility. However, it is unclear on how this could be tested if the activity does not have revenue, emissions, or production data. If such data does exist, then it is probable the activity should not be considered at risk from current emission costs, as it has operated without allocation to date.
- 41 To clarify this process, Cabinet agreed that additional activities continue to be able to seek eligibility. Cabinet also agreed that this process use the updated eligibility thresholds in addition to the consideration of new criteria in section 84C(3) of the Act. Cabinet also agreed activities be able to provide forecast data where they didn't have actual emissions, production and revenue data (with correction provisions).
- 42 Another reason for testing eligibility came to light while discussing a decarbonisation investment with NZ Steel. In a few instances, those investments could result in a fundamental change to how a product is made.
- 43 A significant change to the activity could mean the firm would not be carrying out what's defined in the relevant regulations and as a result would not receive any allocation because of that investment. The improved activity would still face material competitiveness risks because of remaining emissions costs associated with the activity. The proposals I seek agreement to in this paper allow the reformed activity to be tested for eligibility, which could be crucial for decarbonisation investment decisions.
- 44 It is expected many additional industrial activities could be considered eligible for industrial allocation based on updated thresholds. Under the Bill as currently drafted these activities would not automatically become eligible as they would also be subject to the additional considerations set out in section 84C(3) of the

⁶ The Ministry for the Environment estimates that using the current carbon price in regulations (\$67.63), retesting eligibility would result in s 9(2)(b)(ii) activities reclassified as highly emissions intensive which would result in approximately an additional s 9(2)(b)(ii) units allocated annually (this would represent around s 9(2)(b)(ii) of total annual industrial allocation).

Act. There is a lack of comprehensive data to help us understand the risks however.

Industrial allocation can conflict with Government's wider climate change objectives

- 45 Allocating more emission units, by allowing more industrial activities to become eligible and changing the classification of existing activities, could slow the pace of the transition to a low emissions economy.
- 46 This is because increasing industrial allocation means fewer emission units for auction under the NZ ETS cap. In addition to creating fiscal cost to the government, this shifts costs and emission abatement tasks onto other sectors of the economy.
- 47 It also arguably reduces the effectiveness of the NZ ETS price signal. It does this by weakening the net emissions costs eligible industrial activities face, which reduces the incentive to invest in abatement to maintain or improve profitability.
- 48 Industrial allocation should be consistent with New Zealand's broader climate change objectives. It should:
 - 48.1 form part of an enduring framework to reduce emissions out to 2050 and beyond
 - 48.2 drive behavioural change to create a sustainable and climate resilient economy
 - 48.3 help New Zealand to meet its international obligation and domestic budgets and targets. Although industrial allocation should continue to address emissions leakage this should not be at the expense of our legislated climate change commitments.
- 49 Retesting eligibility was intended to reduce overallocation. Increasing industrial allocation by allowing more activities to receive it, is the opposite outcome than was intended. Increasing industrial allocation to reflect an increase in emissions costs is consistent with the objective to mitigate the risk of emissions leakage, and that is how it has been defended in the past.

I have reconsidered eligibility settings for industrial allocation.

- 50 There was divergence amongst submitters on the proposed eligibility changes to the Select Committee.
 - 50.1 Industry groups and businesses considered the changes were necessary. These submitters identified:
 - 50.1.1 low coverage and rates of emissions costs imposed on firms in trading countries;
 - 50.1.2 and that emissions costs in New Zealand were the determining factor for measuring leakage risk.

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- 50.2 The majority of submitters, including the Climate Change Commission and the Parliamentary Commissioner for the Environment noted:
- 50.2.1 the existing and proposed eligibility tests are not based on actual leakage risk, as they were 'imported' when the NZ ETS was being designed to align with settings in Australia;
 - 50.2.2 concern that the proposals could make emission targets harder to meet and have fiscal consequences that could impact funding for emission reduction actions.
- 51 I agree with the latter set of submitters. I seek Cabinet's approval to refine policy decisions regarding eligibility for industrial allocation. NZ ETS settings must make meeting New Zealand's emission budgets and targets easier, not harder. My preferences are as follows:
- 51.1 Retain the existing eligibility decisions and emissions intensity classifications for existing activities.
 - 51.2 Use the existing eligibility thresholds in the Act to test the eligibility of new activities, including those activities that result from the decarbonisation of activities already eligible for industrial allocation.
- 52 In effect, activities classed as moderately or highly emissions intensive will remain that way for the time being. I am concerned that some of these activities, if they were retested now, could be determined to be ineligible. This, combined with potentially sharp changes to allocative baselines, and the shortened two-year period for implementing changes to eligibility, would be a significant economic shock and undoubtedly lead to emissions leakage.
- 53 This proposal does not change the Minister's ability to review the eligibility of activities in the future against existing eligibility thresholds. There may be situations where an activity should no longer be prescribed as eligible, and reviewing eligibility would be the most fiscally and environmentally prudent action.
- 54 Following the passing of the Bill, I only intend to update allocative baselines according to updated information. This will deal with a significant amount of overallocation. I do not intend to reconsider eligibility.
- 55 If the eligibility of some activities should be reviewed, the Minister can use existing powers in the Act to invite the Climate Change Commission to consider these activities. The Climate Change Commission can then recommend the Minister to increase phase out rates to address any overallocation for an emissions budget beginning 2026.
- 56 I propose retaining the existing eligibility thresholds, instead of updating them as proposed by the Bill. This avoids potentially reclassifying many moderately emissions intensive activities as highly emissions intensive and the fiscal cost of allocations to them as a result. It also reduces the number of new activities potentially becoming eligible.

- 57 For new activities, allowing these to be tested for eligibility against current thresholds better prioritises the objectives of the NZ ETS compared to the proposals in the Bill. I do not expect many new activities to become eligible for allocation. Those that do are likely to be the result of decarbonising investments made by existing eligible firms, where that production change means they are no longer carrying the eligible activity.
- 58 To be clear, becoming eligible for industrial allocation will be harder under these thresholds, compared with updated thresholds. For that reason, and because of issues raised by submitters on how section 84C(3) criteria in the Act can be practically applied, I recommend removing that requirement from eligibility decisions as is proposed by the Bill.
- 59 The net effect of these changes is that the eligibility test remains as it is now, with the addition of allowing the use of forecast data. This increases the regulatory and investment certainty for decarbonisation investments.
- 60 However, these changes may impose a greater risk of emissions leakage compared to the proposal currently in the Bill. This risk is limited to those firms in moderately emissions intensive activities. It arises through the combination of not changing the eligibility threshold and not retesting eligibility. The combined impact of increasing emission costs and the phase out of allocation could lead to reduced production, firm closure, and short-term loss of regional and national economic activity.
- 61 I appreciate that emissions pricing is impacting individual firms. This is an obvious and predictable consequence of a rising carbon price. However, as indicated by many submitters to the Bill, industrial allocation is intended to be transitional, as well as predictable and stable. Prioritising mitigating emissions leakage of New Zealand production can conflict with those intentions.
- 62 My recommendations will make the industrial allocation system considerably better aligned with wider emissions goals than the Bill currently does. I therefore consider this increase in leakage risk for a small number of firms acceptable.
- 63 Additionally, the government has other tools besides industrial allocation to manage leakage risk. This included direct financial and knowledge support for decarbonising and transitional support to firms. The equitable transition strategy is likely to support regional economies to adapt to higher emissions costs and economic change. Government is also investigating alternative options to industrial allocation for mitigating the risk of emissions leakage, such as a carbon border adjustment.

Adding to the list of emissions sources counted for industrial allocation settings

- 64 It is important all material emissions costs associated with an activity are counted for the purpose of determining eligibility and allocative baselines. Undercounting emissions costs could increase the risk of emissions leakage.

- 65 It could also act as a barrier to investments in decarbonisation projects. For example, I have been made aware of some emissions sources that face an NZ ETS cost, but cannot be counted for industrial allocation settings. These are:
- 65.1 Emissions from combusting used tyres (from Golden Bay Cement's partial replacement of coal with used tyres to generate process heat).
- 65.2 Using CO₂ as a feedstock (Ballance Agri-Nutrients have noted its intention to replace natural gas use with hydrogen which will require external CO₂).
- 66 Combusting used tyres for energy is a mandatory activity in the NZ ETS. Participants, including Golden Bay Cement, face direct surrender obligations.⁷
- 67 The Act currently does not allow industrial allocation settings to count emissions (and therefore costs) associated with combusting used tyres for energy. This is because it is not an included emissions source in the Act.
- 68 The purchase of large amounts of CO₂ for use as a feedstock will carry emissions costs. CO₂ is a by-product from refining Kapuni natural gas, and the natural gas miner must surrender emission units for all emissions associated with its production.
- 69 Adding these emission sources would require an addition to the Bill. Section 161E(2)(a) prescribes what emissions sources can be included when considering eligibility and determining allocative baselines. These include the direct use of coal, natural gas, geothermal fluid and waste or used oil.
- 70 The list also includes liquid fossil fuel used in stationary equipment, fugitive coal seam methane, chemical process emissions and indirect emissions costs from electricity use. The list was last updated in 2013.
- 71 I therefore recommend that combusting used tyres for energy and the use of CO₂ as a feedstock be both added to that list of emission sources through amendment to section 161E(2)(a) of the Act.

Delaying the requirement for the Electricity Authority to model the EAF

- 72 The impact of the NZ ETS on electricity prices is described by the electricity allocation factor (the EAF). The EAF is used in calculating industrial allocation.
- 73 Cabinet agreed to require the EA to recommend a value for the EAF to the Minister by the end of July each year. The EA has advised it is not possible to meet that requirement if the Bill is enacted any time in July this year.
- 74 Officials will recommend to the Committee that the requirement on the EA be delayed until July 2024. This does not require a Cabinet decision as the timing, specifically which year, is not a change to government policy.

⁷ Schedule 3, Part 3, Subpart 1 of the Act: Combusting used oil, waste oil, used tyres or waste for the purpose of generating electricity or industrial heat.

Implementation

- 75 A data collection exercise, necessary to inform decisions on updates to allocative baselines, is being planned to start following the enactment of the Bill. The earliest that allocative baselines can be updated is mid-2024. Those updates will impact allocations for the 2024 calendar year.

Milestone/Activity	Timeframe
Departmental report due to Select Committee	22 May 2023
Select Committee report due	20 July
Second reading, Committee of the Whole House, third reading and enactment	Late July – 31 August
Data collection and updating of allocative baselines	Late 2023 – late 2024

Financial Implications

- 76 In 2021, industrial allocation policy had a fiscal cost of \$578 million. Fiscal costs from industrial allocation arise from the Government's cap on the supply of emission units into the economy. Those that are not required for allocation can be auctioned, raising cash for the Crown.
- 77 The proposed changes in this paper will significantly reduce the fiscal risk of existing industrial activities becoming eligible to receive industrial allocation because of the Bill as it is currently drafted. It is not possible to value the likely fiscal saving from these changes. Officials have very limited data on who could be eligible under the current Bill provisions, and what their emissions per unit of production are.

Legislative Implications

- 78 Subject to Cabinet decisions, my recommendations will be included in the departmental report recommendations to the Select Committee for inclusion in the revision-tracked version of the Bill or via Supplementary Order Paper (dependent on timing).

Impact Analysis

Regulatory Impact Statement

- 79 The Minister of the Environment's Regulatory Impact Analysis Panel has reviewed this Regulatory Impact Statement, which now changes some preferred options, and has added analysis of new options for dealing with eligible emissions sources. The previous assessment of the panel is unchanged i.e., the RIS partially meets the quality assurance criteria.
- 80 The analysis does make a good case for change, and the changes to reflect consultation feedback show good evidence of adequate consultation. However, as noted in the previous QA statement the analysis is not presented in a way

that is readily understood by decision-makers or the public, and the insertion of additional analysis has not eased this problem.

Climate Implications of Policy Assessment

- 81 The Climate Implications of Policy Assessment (CIPA) team confirmed that the CIPA requirement did not apply to the policy proposals approved by Cabinet in July 2022 [CAB-22-MIN-0250 refers]. This was because there is either no direct impact on emissions or because the threshold for significant was not met. This also applies to the proposals in this paper.

Te Tiriti o Waitangi / Treaty of Waitangi Implications

- 82 Te Tiriti/Treaty principles require that the Crown be properly informed of Māori interests and act reasonably and with the utmost good faith towards Māori. Māori have a significant stake in climate policy.
- 83 Māori have a significant stake in climate change and interest in the NZ ETS. This is driven by a commitment to reduce emissions and address climate change, and the potential impacts of emissions pricing on Māori involvement in agriculture and manufacturing – particularly as these sectors are important for Māori economic development and employment.
- 84 Māori generally do not have a direct interest in industrial allocation. It is mainly of interest to EITE firms receiving industrial allocation – many of which are owned or majority-owned by overseas owned. This means that no targeted engagement with Māori was carried out to inform the wider set of changes to industrial allocation, beyond public consultation on the policy proposals in 2021 and on the Bill in 2023.
- 85 There could be potential indirect impacts for Māori. My new proposals could increase the risk that New Zealand firms reduce production or close because of emissions pricing, compared to the proposals in the Bill. On the other hand, if firms reduce their emissions because of the price incentives, their costs will go down and there would be no effect on production or employment.

Population Implications

- 86 There are no population implications of the proposed policy changes.

Human Rights

- 87 The proposals in this paper are consistent with the New Zealand Bill of Rights Act 1990 and the Human rights Act 1993.

Consultation

- 88 The Bill was introduced into the House and made publicly available on 2 December 2022. Following the Bill's first reading and referral to the Committee on 21 February 2023, the Committee sought submissions on the Bill by 6 April. 110 submissions were received. Many were form submissions with one such submitter noting it had the support of 3000 petition signatories.

- 89 The following agencies were consulted on this paper: Ministry of Business, Innovation and Employment, the Treasury, the Ministry of Foreign Affairs and Trade, the Ministry for Primary Industries, Te Manatū Waka Ministry of Transport, the Inland Revenue Department, and the Environmental Protection Agency. Te Puni Kōkiri and the Department of the Prime Minister and Cabinet were informed.

Communications

- 90 Officials will recommend changes to the Bill to the Environment Select Committee via the departmental report. These changes will become public once the Committee reports on the Bill to the House.

Proactive Release

- 91 I intend to proactively release this paper on the Ministry for the Environment's website, subject to redactions consistent with the Officials Information Act 1982, following the enactment of the Bill.

Recommendations

The Minister of Climate Change recommends that the Committee:

- 1 **note** that the Climate Change Response (Late Payment Penalties and Industrial Allocation) Amendment Bill (the Bill) will amend industrial allocation policy in the New Zealand Emissions Trading Scheme (NZ ETS) and introduce a revised penalty for small forestry participants;
- 2 **note** the Bill was introduced in December 2022, had its first reading and was referred to the Environment Select Committee in February 2023;
- 3 **note** that I am not seeking any changes to the part of the Bill relating to the late payment penalty for small forestry participants;

Eligibility for industrial allocation for existing activities and eligibility for new activities

- 4 **note** the eligibility tests for industrial allocation within the Bill mitigate emissions leakage while maintaining incentive to reduce emissions;
- 5 **note** that mitigating leakage risk to the degree proposed by in clause 15(1)-(3) of the Bill (which proposes updating eligibility thresholds using a more recent carbon price) is inconsistent with wider Government attention to meeting emission budgets and targets and imposes fiscal costs as it is expected to lead to increases in industrial allocation;
- 6 **agree** to amend the Bill to:
 - 6.1 retain the eligibility thresholds currently prescribed in the Climate Change Response Act 2002 (the Act) by removing clause 15(1)-(3);
 - 6.2 remove the Bill's requirement for new activities to be tested against the criteria in section 84C of the Act;

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- 6.3 not require the Minister to retest the eligibility of currently eligible activities;
- 7 **note** those changes will support decarbonising investments and allow new activities to be eligible, but also rebalance industrial allocation settings towards supporting the transition to a low emissions economy;

Including additional sources of emissions costs

- 8 **note** I have been made aware of two emissions sources (combusting used tyres and consuming CO₂) that have an associated emissions price but cannot be counted within eligibility tests and allocative baselines;
- 9 **note** these omissions results in inconsistent treatment of priced emissions sources eligible for allocation and could disincentive decarbonisation investments;
- 10 **agree** these combusting used tyres and consuming CO₂ be counted in industrial allocation settings through amendment to the Bill, where an emissions price is faced;

Starting year for EAF recommendations

- 11 **note** the Bill requires the Electricity Authority to recommend a value for the electricity allocation factor to you by the end of July each year;
- 12 **note** the EA have advised us it is not possible for them to meet that requirement if the Bill is enacted any time in July this year, due to the complexity of the modelling task;
- 13 **note** officials will recommend to the Select Committee that the requirement on the EA be delayed until July 2024;

Next steps

- 14 **agree** the proposals in this paper will be included in the departmental report recommendations to the Select Committee for inclusion in the revision-tracked version of the Bill or via Supplementary Order Paper (dependent on timing).

Authorised for lodgement

Hon James Shaw

Minister of Climate Change