

## File note on meeting between ETG and business reps on RIA

Midday to 1:45pm, 28 June 2007, The Treasury, 2 The Terrace, Wellington

Emissions Trading Group (ETG) representatives: Dave Brash (General Manager), Amy Kearse (Senior Advisor), John Scott (Senior Analyst) and Peter Wilson (Director)

Business representatives: Brent Layton (NZIER), Bryce Wilkinson (Capital Economics) and Ralph Matthes (MEUG)

### Purpose and introduction

1. The meeting was held on a Chatham House Rule basis and that any views of officials on issues that Ministers had yet to consider would not be revealed.
2. The purpose of the meeting was to discuss the methodology for the preparation of a Regulatory Impact Assessment (RIA) by the (ETG).
3. The ETG is a joint MfE and Treasury group, currently with 12 staff and expected to complete their work within next ½ year. The ETG report to Ministers Cullen and Parker who in turn jointly report to Cabinet. The task of the ETG is to develop more detail on emissions trading options so Ministers can make more informed decisions. No decision to have emissions trading has yet been taken.
4. There are many interrelated government agencies working on climate change policies, eg<sup>1</sup>:

Work	Lead agency
Possible 2 <sup>nd</sup> Kyoto commitment period agreement	MFAT
NZES	MED
NZEECS	EECA
Transport policies	MoT
Land use change	MAF
Joint NZ & Australian government initiatives announced by H Clark and P Howard <sup>2</sup>	
Emissions Trading Group (ETG)	MfE/Tsy

5. Recommendations to Cabinet by the various Ministers involved all require RIA reports. The recently formed Regulatory Impact Assessment Unit of MED is also closely involved in key aspects of climate change policy work.
6. There has been some slippage (by several weeks rather than months at this stage) in project timing compared to the 8<sup>th</sup> May 2007 timetable released by Minister Parker to media. The value of ongoing dialogue with interested parties as work progresses was discussed.

### RIA policy problem definition

7. Developing climate change policies is complex because unbundling cause and effect and solutions from problems in terms of climate science, domestic (NZ) economics and international affairs is complex and all are interrelated. .
8. In New Zealand's case it is not clear what the key problem is that policies might be intended to solve. Possible policy problems include:
  - the risk to New Zealand trade from harmful international repercussions (eg the food miles issue);
  - the risks to New Zealand trade/diplomatic/international relationship aspects from siding with one grouping (eg the EU) rather than another (eg Australia and the US);
  - the possible risks to the welfare of New Zealanders from unchecked climate change;

<sup>1</sup> Other government resourced work streams not discussed at the meeting include FRST and MORST work on mitigation, adaptation and climate change science.

<sup>2</sup> At the international political level could add Ministerial discussions at APEC and CHOGM.

- the risks to the welfare of New Zealanders from government failure in the form of policies that make future New Zealanders less prosperous, for no discernible reduction in climatic or other risks;
  - the risk to the welfare of New Zealanders overall because some groups seek to use the political process to benefit at the expense of other groups of New Zealanders;
  - finding the least cost way for the government to meet its expected Kyoto Agreement Commitment Period 1 (CP1) liability.
9. Setting the correct hierarchy of policy problems to be solved and weighting them in terms of importance needs to be carefully undertaken. The business representatives illustrated this point with the following example: If there were a low tax in the near term then this would provide the option of shifting to a trading emissions scheme with similar trading partners once those schemes were in place. This option might achieve minimal cost to GDP and maintain our current level of "green" branding but would not assist the government minimise its expected Kyoto Agreement liability as there would be minimal reduction in GHG before 2012 compared to the status quo. On the other hand, withdrawing from Kyoto in accordance with its processes is a solution to the last of the problems listed above, but it could exacerbate other risks. Unless there is clarity about the real problem, policy failure is likely.
10. While the ETG RIA is focussed on the final policy problem definition listed in paragraph 8 above, the discussion at the meeting covered all the possible problem definitions

#### **RIA methodology**

11. The pros and cons of using General Equilibrium (GE) model or analysis of changes in supplier and consumer welfare surplus (sector/multi-sector CBA) approach were discussed. Both have pros and cons. There was a general preference for CBA although appropriate GE modelling as an adjunct to CBA work could be helpful to policy makers.

#### **RIA counterfactual and options**

12. All agreed the counterfactual should be the status quo. The RIA will go well beyond 2012 given the global nature and long time frames of both the science and international negotiations on the topic.
13. The status quo could best be described as a range of outcomes as the assumptions that define the status quo are subject to a range of uncertainty. Those factors include:
- The forecast rate of global and New Zealand specific temperature change;
  - The forecast impact and relative change on the global and New Zealand economy due to changes in temperature<sup>3</sup>;
  - The price of internationally traded C to 2012 and beyond;
  - Rate of change in developing new mitigation and adaptation technologies;
  - Irrespective of any government tax or emission trading policies, the forecast rate of mitigation and adaptation by sectors themselves.
14. The RIA requires all feasible options to be considered. This may be a daunting task but what's at stake and the risks of poor decisions is also daunting.
15. A common feature of all options was likely to be the need for new policies to ensure consistent and accurate measurement of GHG emissions across all sectors.
16. In selecting options to consider one trade-off worth exploring is the choice between NZ taking significant policy actions later versus earlier. Stern recommended governments make significant and early government interventions, a recommendation that leading modeller, William Nordhaus, observed rested on novel and extreme propositions about the

<sup>3</sup> This wasn't discussed in detail but there is a view that rising temperatures might not be as harmful to New Zealand as other countries. Rising temperatures might have a net beneficial effect to the New Zealand economy, eg higher pasture growing rates and lower electricity demand for more benign winters. However if countries we export to have decreased GDP due to rising global temperature then even if we can produce more, we may have smaller markets to sell output.

discount rate and that sought, thereby unsuccessfully to overturn the mainstream finding that a gradual 'policy ramp' approach to reducing global emissions would be optimal (assuming of course that the damaging global warming scenarios are correct). A fundamental point is that the costs of reducing emissions in future should be lower because of technology. Given the fundamental importance of ensuring that any argument for urgent radical reductions in emissions was soundly-based, a copy of the Nordhaus assessment to the contrary was provided after the meeting. .

17. The choice between taxes and permits was discussed. Taxes are a feasible option. As the focus of the ETG is on selecting the best trading regime assuming government decides against taxes, the ETG RIA will not consider the tax option. Some other department(s) presumably will be conducting a RIA to assist government weigh the tax option versus trading option.
18. The option of dealing with the Kyoto CP1 liability by withdrawing from the obligation in accordance with its provisions was discussed. It was noted that MED's Guidelines on the Regulatory Impact Analysis Requirements, March 2007, state (p 17) that "all feasible options should be considered." There was a discussion on whether or not withdrawing from the Kyoto CP1 liability was feasible in terms of the options to be considered in a RIA.
19. The option of NZ climate change policy matching that of Australia was discussed. The main reason why policies might differ appeared to be that NZ had a CP1 liability whereas Australia doesn't. There was no agreement that this was a sufficient reason for the policies to differ.

#### **RIA assumptions**

20. Expert advice within Treasury has been sought on the appropriate discount rate. Officials were aware of the academic critiques critical of the very low discount rates assumed by Stern.
21. Forecast international traded C prices are usually viewed by media to be ever increasing. There is an alternative view that as the number of participating countries and volumes of GHG trading expands, coupled with advances in technology, C prices will decrease.
22. There is a need to ensure assumptions and modelled effects with respect to C pricing for a RIA are consistent, eg if assume increasing and very high future C price then there will be an incentive to emit more now and much less later compared to the counterfactual – some might call this "perverse" but it would also be efficient.
23. In estimating compliance costs care is needed to ensure all costs are taken into account, both government and private sector compliance costs. Working through what will be implementation and compliance costs for each option could be time consuming; although the preferences for as simple an approach as possible should assist avoid excessive compliance costs.

#### **Concluding comment**

24. At the end of the meeting officials tabled a copy of a speech by John Whitehead, Secretary to the Treasury, *Climate Change – Challenges for NZ in an Economic and Wider Context*, 23 June 2007<sup>4</sup>.
25. Everybody agreed the discussion had been useful.

Ralph Matthes  
7 August 2007

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<sup>4</sup> Refer <http://www.treasury.govt.nz/speeches/climatechange/>