(14)

Allocation to pre-1990 forestry

- Intended to be partial compensation for reduced land values due to ETS deforestation liabilities.
- Total allocation package was based on historic deforestation levels before 2007 (about 5% of harvested P90 forest).
- Individual landowner allocation was distributed *pro rata*. Not possible to target allocation to those most impacted (e.g. landowners likely to convert from forestry to higher value land).

Value of offsetting

- Allows forest owners to avoid deforestation costs under ETS, provided they establish a new forest elsewhere on post-1989 eligible land.
- Transfers the ETS deforestation liability away from land with higher land value uses.
- Offsetting reduces conversion costs by 50% (at current carbon prices) to 75% (at $25 tC)
- Offsetting does not eliminate land conversion costs completely.

Rationale for cancelling 2nd tranche

- For foresters actually seeking to convert their land, offsetting is worth more than the 2nd tranche of allocation.
- Where forestry is the best use of the land, landowners have arguably already been over-compensated under P90 forest allocation.
- Relative to the status quo, all pre-1990 forest owners arguably benefit from offsetting, regardless of whether they take it up.

Value of pre-1990 allocation	No. of NZUs	% of allocation	Total value at $25 t/C ($ million)	Total value at $10.41 t/C ($ million)	Per hectare value at $25 t/C	Per hectare value at $10.41 t/C
1st tranche	20.0 million	38% (CP1)	$500.0	$208.2	$400.00	$166.56
2nd Tranche	30.9 million	62% (CP2)	$772.5	$321.7	$618.00	$257.34

Value of offsetting per hectare of 28-year old radiata pine	Deforestation liability with current ETS	Comparative net benefit of offsetting	% reduction in conversion costs
$25 carbon price	$20,000	$15,000	75%
$10.41 carbon price	$8,000	$4,400	50%

Relative targeting of offsetting & allocation compensation

Forest owners impacted by ETS deforestation liabilities (Note: Landowners desire to offset may not always reflect capability of land)

	LOWER IMPACT Forestry is highest capability (~70-80% of P90 land)	HIGHER IMPACT – Land has potentially alternate uses than forestry Larger land owners	Smaller land owners	Long-term cutting rights sold to third parties
Effect of 2nd tranche:→	Windfall gain ($280-930 (*18-60 NZUs*) per ha)	Partial compensation for costs (1-5% of $20k/ha)	Partial compensation for costs (1-5% of $20k/ha)	Partial compensation for costs (1-5% of $20k/ha)
Potential for offsetting:→	Low – limited potential for conversion ↓	High – likely to convert. Reduces conversion costs by 75% ↓	Moderate – unlikely to convert. If decide to, future conversion costs reduced by 75% ↓	Med-high – Can't convert in short-term. Reduces *likely future* conversion costs by 75% (at $25 tC) ↓
Net impact of replacing 2nd tranche with offsetting:	Loss of 2nd tranche $280-930 per ha **= Net loss of (arguably unneeded) compensation**	Net offsetting benefit ($15k) minus 2nd tranche ≈ $14,500/ha **= Significant net gain**	Immediate net loss *plus* Potential future significant gains **= Variable impact**	Net offsetting benefit ($15k) minus 2nd tranche ≈ $14,500/ha **= Significant potential future net gain**

'Winners' from offsetting

- Those who will benefit most from offsetting will be landowners whose pre-1990 forest land has alternate uses than forestry (~ 5% better suited for pastoral use).
- Offsetting provides least benefit to:
  - Landowners whose land is best suited to forestry
  - smaller landowners
  - landowners who have sold long-term cutting rights to third parties
  - A large percentage of Maori-owned P90 land is likely to fall into these categories.

Impacts on iwi:

- 14-16m of 2nd tranche NZUs estimated to go to iwi (around 50%). Of this:
  - 6m to iwi who settled Treaty claims before the introduction of the ETS.
  - 2m to iwi who settled during or after the forestry allocation plan development.
  - 3m to iwi who have yet to settle.
  - 3-5m to Māori freehold land.
- Interest in offsetting and potential for conversion unknown for many iwi. However:
  - Ngai Tahu known to be interested in offsetting and conversion to dairy, though best use of land may be in forestry.
  - For CNI, Tainui and Māori freehold land, majority of forest land likely to be better suited in forestry. However the intentions for conversion are unknown.

Withheld under section s 9 (2) (h)

Proportion of second tranche that should be cancelled to achieve fiscal neutrality

- **About 50–60 percent (approximately $160–193m) of the second tranche** of pre-1990 forest allocation would have to be cancelled to make the ETS amendment package fiscally neutral, if the transition phase (one for two obligation) were to be extended and phased out as proposed by the ETS Review Panel.
- **About 6 percent (approximately $18m) of the second tranche** of pre-1990 forest allocation would have to be cancelled to make the ETS amendment package fiscally neutral, if the transition phase were not extended beyond 2012.

Fiscal savings of proposed policy changes (excluding cancellation of second tranche), excluding administrative costs

Fiscal savings ($ million)	Increase/(decrease) in operating balance					
	2011/12	2012/13	2013/14	2014/15	2015/16	Total
Updated Global Warming Potentials	-	1.203	2.707	5.973	8.940	18.823
Other proposals	-	0.260	0.521	0.521	0.521	1.822
Total ($ million)	-	**1.463**	**3.228**	**6.494**	**9.460**	**20.645**

Note:
- The estimates for the fiscal impacts of policy proposals are based on a carbon price of $10.41 per unit and IPCC AR2 Global Warming Potentials.
- In the tables above, "other proposals" denote the technical and operational amendments that have not been included in the first Cabinet paper on the
- significant proposed amendments to the Climate Change Response Act 2002. These amendments relate to the operational settings for the agriculture, forestry, waste and synthetic greenhouse gases sectors

Fiscal cost of proposed policy changes, excluding administrative costs

Fiscal savings ($ million)	Increase/(decrease) in operating balance					
	2011/12	2012/13	2013/14	2014/15	2015/16	Total
Transition phase—gradual phase-out of 2:1 surrender obligation	-	(34.268)	(80.609)	(32.854)	-	(147.731)
Implementation costs for transition phase changes	-	(0.380)	(0.250)	(0.250)	(0.125)	(1.005)
Other proposals	-	(1.829)	(5.084)	(7.447)	(9.908)	(24.268)
Implementation costs for other proposals	-	(8.365)	(1.845)	(1.963)	(2.055)	(14.228)
Total ($ million)	-	**(44.842)**	**(87.789)**	**(42.514)**	**(12.088)**	**(187.232)**

Extension of the transition phase

For:
- From 2013 onward, the ETS is projected to place greater costs on emitters than an international liability faced by the Government or action taken by comparator countries. Under current legislative settings, the ETS is projected to achieve emissions reductions of between 30-40 percent below 1990 levels.
- Removing the transition phase beyond 2012 will have a minimal effect on carbon emissions relative to costs, as the carbon price is a small component of relatively inelastic petrol and electricity commodities.

Against:
- Carbon prices have fallen significantly in recent months (since the ETS Review Panel made their recommendations) the CER price has fallen to $10.41 in January 2012 and the NZU price is at a similar level. There is no evidence that carbon prices are likely to rise significantly in the period to 2015.
- This means that ending the transition phase at the end of 2012 is not expected to have significant impacts on electricity and fuel prices and therefore household and business expenditure.
- There is some anecdotal evidence that energy suppliers appear to be passing through carbon costs at $25, regardless of the market carbon price and the one-for-two surrender obligation. Research conducted on behalf of Horticulture New Zealand suggests that some coal suppliers are passing on a cost close to the $25 per NZU level. However, evidence from the Emission Unit Registry confirms that no coal suppliers used the $25 fixed price option to meet their surrender obligations. Excessive pass-through costs are symptoms of a lack of market competition, which if substantiated would be addressed through market competition regulation.

Impacts of ETS with and without 2:1 surrender obligation (assuming carbon price is $10.41 per unit)

With 2:1 surrender obligation	Estimated ETS effect on price	Unit
Premium petrol	1.3	cents per litre
Regular petrol	1.3	cents per litre
Diesel	1.5	cents per litre
Electricity	0.3	c/kWh

Without 2:1 surrender obligation (i.e. full surrender obligation)	Estimated ETS effect on price	Unit
Premium petrol	2.6	cents per litre
Regular petrol	2.6	cents per litre
Diesel	2.9	cents per litre
Electricity	0.5	c/kWh

Estimated impacts on business and consumers

Impact	Status Quo (i.e. full surrender obligation from 2013)	Government's preferred option (i.e. gradual phase-out of one-for-two surrender obligation, full surrender obligation from 2015)
Impact on total business expenditure on electricity and fuels $ million (% GDP)		
2012	$146m (0.1% GDP)	$146m (0.1% GDP)
2013	$293m (0.2% GDP)	$196m (0.1% GDP)
2014	$293m (0.2% GDP)	$243m(0.1% GDP)
2015	$293m (0.2% GDP)	$293m (0.2% GDP)
Impact on average household expenditure on electricity and fuels $ per annum (% gross income)		
2012	$55 p.a. (0.1%)	$55 p.a. (0.1%)
2013	$111 p.a. (0.1%)	$74 p.a. (0.1%)
2014	$111 p.a. (0.1%)	$92 p.a. (0.1%)
2015	$111 p.a. (0.1%)	$111 p.a. (0.1%)