

The Treasury

Budget 2021 Information Release

August 2021

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- [38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice
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- [40] Not in scope
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Treasury Report: Budget 2021 Advice for Meeting with Climate Ministers

Date:	11 December 2020	Report No:	T2020/3768
		File Number:	SH-10-8

Action sought

	Action sought	Deadline
Hon Grant Robertson Minister of Finance	<p>Note this advice ahead of your Budget 2021 discussion with the Ministers of Climate Change, Energy and Resources, Environment, Transport, Agriculture and Conservation.</p> <p>Raise the speaking points suggested in this report.</p>	17 December 2020
Hon Dr Megan Woods Associate Minister of Finance		

Contact for telephone discussion (if required)

Name	Position	Telephone	1st Contact	
Callum Lo	Graduate Analyst, Transitions, Regions, and Economic Development	[39]	N/A	✓
Jean Le Roux	Manager, Transitions, Regions, and Economic Development		N/A	

Minister's Office actions (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report

Enclosure: No

Treasury Report: Budget 2021 Advice for Meeting with Climate Ministers

Executive Summary

The Government will be making a series of important decisions on its approach to climate change policy throughout 2021. Many of these will have significant fiscal consequences, and these will come into clearer view as the policy process develops throughout the year. There is an overall tension to navigate between the parallel development of the Government's overall policy strategy, and the funding certainty required to deliver timely action to address the long-term objectives of climate policy.

This report provides you with an overview of initiatives submitted by Ministers across portfolios for consideration in Budget 2021, that relate to climate change policy. A number of these are likely to meet your criteria to be invited to submit bids in the Budget 2021 process. Annex Two of this report provides an initial assessment of the initiatives we are aware of at the time of finalising this report.

New Zealand will need the right mix of public and private investment to be mobilised to meet its objectives for climate change. Some options raised for consideration in Budget 2021 will give Ministers the chance to consider a strategic approach to these long-term funding and financing questions. This report provides you with some initial principles, trade-offs and options to inform those discussions. This advice will be further developed in the first few months of 2021 to inform advice to Cabinet in parallel to the Budget 2021 process.

At your meeting with these Ministers, you may want to raise these questions to prompt collective discussion on how the fiscal and economic impacts of climate policy can be managed across the three Budgets in this parliamentary term:

- What are your highest priority initiatives for climate change in Budget 2021 and later budgets this term?
- How are you thinking about linkages between your portfolios and how can they work together to achieve the Government's climate objectives?
- How do you see your climate related initiatives contributing to the Government's wider economic and social objectives?

Recommended Action

We recommend that you:

- a. **note** the advice about climate change-related initiatives in key portfolios ahead of your meeting with the Ministers of Climate Change, Energy and Resources, Environment, Transport, Agriculture and Conservation;
- b. **raise** the talking points suggested in Annex One of this report in your Budget 2021 multilateral discussion on 17 December.

Jean Le Roux
Manager, Transitions, Regions, and Economic Development

Hon Grant Robertson
Minister of Finance

Treasury Report: Budget 2021 Advice for Meeting with Climate Ministers

Purpose of Report

1. This report provides you with background and talking points to support your climate change budget meeting with the Ministers of Climate Change, Energy and Resources, Environment, Transport, Agriculture and Conservation on Thursday 17 December.
2. The first section of this report sets out the general context for climate change policy in 2021, given the range of significant decisions the Government will take throughout the year.
3. The second section of this report provides you with the Treasury's initial view on which climate change initiatives submitted by Ministers could be invited for consideration in Budget 2021, based on whether they are likely to meet your criteria of high priority and time sensitive manifesto commitments, or critical cost pressures. [34]
4. The third section of this report provides you with advice that could inform the Government's consideration of funding and financing of climate policy over the longer term, where decisions could be made in Budgets 2021 or later.

Background and Context

5. A series of climate policy decisions are coming up in 2021. Reducing emissions in line with New Zealand's targets will involve work across major emitting sectors including industry, transport and agriculture as well as Government. Setting strategic direction for adapting to climate change will also be important.
6. [33]
 - a. [33]
 - b.
 - c.

d. [33]

7. Many of the decisions being progressed through this work programme will have major fiscal consequences. As further policy work progresses, officials and Ministers will better understand the economic and fiscal trade-offs associated with adopting different policy frameworks to address these major climate policy challenges. This policy development will progress in parallel to consideration of initiatives through the Budget 2021 process.
8. The Minister of Climate Change has raised a particular challenge with respect to the timing of this parallel policy and fiscal decision-making process. This is that Budget 2021 decisions will have been made before the Climate Change Commission issues its final advice to Government by the end of May. Subsequently, the Government is required to consult on and agree to its Emissions Reduction Plan and Emissions Budget in late 2021.
9. If fiscal decisions to support the Emissions Reduction Plan (ERP) need to be delayed until Budget 2022, then there could be a delay in delivering action on emissions reduction at a time when New Zealand's Nationally Determined Contribution (NDC) under the Paris Agreement will have already begun.
10. Potentially, this does raise a tension with your overall Budget strategy to limit the use of tagged contingencies and future Budget pre-commitments. The Treasury will continue to provide you with advice on this matter throughout the Budget 2021 process, as the extent of this issue becomes clearer.

Key Funding Issues – Budget 2021

11. This section sets out a short summary of each of the six portfolios covered in the meeting. Each summary indicates the Treasury's initial judgement of initiatives most likely to meet the criteria of being a high priority and time sensitive manifesto commitment, or a critical cost pressure. Annex Two provides a list of all the climate related cost pressures and initiatives requested in each portfolio we are aware of, with initial vote analyst comments.
12. In the time available, the Treasury has not been able to reach a definitive view on whether it would be appropriate or not to invite all the climate change initiatives from Ministers into the Budget 2021 process. Judgements in this section and Annex Two should be read as tentative, and are provided to inform your initial discussion with Climate Ministers.
13. Many portfolios have received funding in recent Budgets or through the Covid-19 Response and Recovery Fund (CRRF). Effective delivery or reprioritisation of that funding should be a priority. Delivery of existing initiatives will also be considered when assessing invited initiatives in February 2021.
14. The relative merits of the invited initiatives will be assessed later, in February 2021. With regard to reducing emissions, the focus of that later assessment will be to identify what new initiatives could best join existing work in a climate policy portfolio that meets a range of criteria including:
 - greatest emissions reductions at least fiscal and economic cost;

- starting longer term actions to unlock future reductions in hard-to-abate sectors;
- delivering on wider Government economic and social objectives; and
- taking account of the ETS and other emissions pricing, non-spending regulatory options, and distributional impacts.

Climate Change portfolio

15. The Minister for Climate Change is responsible for climate appropriations in Vote Environment of \$1.2 billion for 2020/21.
16. The vast bulk of this relates to the allocation of carbon credits into the economy, and administering the Emissions Trading Scheme.
17. It also includes nearly \$20 million for policy advice and support for domestic and international climate change programmes, and nearly \$9 million in funding provided to the Climate Change Commission.
18. The initiatives within the Climate Change portfolio that most closely meet criteria for Budget 2021 consideration are:
 - Implementation of the Carbon Neutral Government Programme;
 - [33]
 - Capability cost pressure for the Climate Change Commission; and
 - Capability and capacity related cost pressures for five Ministry for the Environment (MfE) climate work programmes (which also relate to manifesto items such as the Managed Retreat Act within the RMA review).
19. The Climate Change portfolio received \$47 million at Budget 2019 for the Productive and Sustainable Land Use initiative, including funding for the Climate Change Commission. Through the Infrastructure Reference Group (IRG) Shovel Ready projects process, a \$211.7m climate resilience package was approved in principle to deliver flood protection projects across the country.

Energy and Resources portfolio

20. In 2018, the heat industry and power sector accounted for 25.9% of New Zealand's total gross greenhouse gas emissions. This includes manufacturing, construction, electricity generation, and production of cement, steel and aluminium.
21. The ETS is a primary mechanism for emission reductions in this sector, though complementary measures such as direct investment or regulatory change can overcome barriers and support transition. [33]
22. The climate-related initiatives within the Energy and Resources portfolio that most closely meet criteria for Budget 2021 consideration are:

- [33]
 - Expansion of EECA business support programmes;
 - Increasing the Low Emissions Vehicle Contestable Fund; and
 - Expansion of the State Sector Decarbonisation Fund.
23. The Energy and Resources portfolio has received substantial funding in recent rounds for climate-related initiatives, including \$47 million at Budget 2019, \$200 million for the State Sector Decarbonisation Fund, \$100 million through Infrastructure Reference Group projects, and \$175 million through the Covid-19 Response and Recovery Fund (CRRF).

Environment portfolio

24. The Minister for the Environment is responsible for a number of areas that are related to climate change. These include policy advice, waste minimisation initiatives and funding for the Environmental Protection Authority to manage the ETS. Both the Environment and Climate Change portfolios sit within Vote Environment.
25. The climate-related initiatives within the Environment portfolio that most closely meet criteria for Budget 2021 consideration are:
- Waste Action Plan;
 - Cost pressures for the Ministry for the Environment for policy work on Resource Management Act Reform; and
 - Environmental monitoring and reporting system.
26. The Environment portfolio has received \$65.9 million through Budgets 2019 and 2020 for climate-related initiatives.

Transport portfolio

27. In 2018, transport made up 21.1% of New Zealand's gross emissions. Of this, over 90% of transport emissions are from road transport, such as road freight and passenger vehicles.
28. Current policies contributing to reducing emissions in transport include the ETS, Low Emission Vehicle Contestable Fund, and wider investments in public transport and active transport modes. Transport emissions have been growing rapidly, by 90% since 1990, and further action is likely required to meet long term climate targets.
29. The Ministry of Transport is developing a Transport Emissions Reduction Plan (TEAP) which will set out a strategic approach to reducing transport emissions, including how investments could be prioritised and sequenced. The TEAP is expected to be finalised by February 2021 and will feed into the ERP.
30. Climate-related initiatives within the Transport portfolio that most closely meet criteria for Budget 2021 consideration are:

- A Clean Car Standard; and
 - [33]
31. It is important to note that the Energy and Resources Portfolio covers the manifesto commitment to increase the Low Emissions Vehicle Contestable Fund, which will also serve to reduce transport emissions. Beyond Budget 2021, the TEAP is expected to support a strategic approach to guide a wider package of emissions reductions in the transport sector.
32. The Transport portfolio has received over \$3 billion in funding over the last two Budgets for initiatives that are climate-adjacent, mostly through substantial investment in rail.

Agriculture portfolio

33. Agriculture is responsible for approximately half of New Zealand's gross greenhouse gas emissions. The Government is committed to partnering with Māori and the sector, to provide a knowledge base and toolkit to help producers calculate and reduce their greenhouse gas emissions and adapt to climate change.
34. In 2019 the Government agreed to allow the agriculture sector to develop a pricing scheme for on-farm emissions. However, if the sector has not made sufficient progress by 2022, the Government has committed to bring agriculture into the NZ ETS in 2025.
35. Climate-related initiatives within the Agriculture portfolio that most closely meet criteria for Budget 2021 consideration are:
- Increasing Agricultural Climate Change Research; and
 - Integrated Farm Plans.
36. The Agriculture portfolio has received a total of \$166 million in funding through Budgets 2019 and 2020 for climate-related initiatives.

Conservation portfolio

37. [33]
38. The Minister of Conservation may raise the Department of Conservation-managed Jobs for Nature programme (focus on delivery, no additional funding requested) or the request for Budget 2021 support to strengthen emergency management, both of which may have indirect links to being better prepared for natural disasters including those exacerbated by climate change.

Other portfolios

39. A number of portfolios not represented at this meeting have climate-related manifesto commitments that are assessed as likely to meet criteria for Budget 2021 consideration. These are noted in **Annex Two**.

Longer Term Funding and Financing for Climate Policy Objectives

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43. Therefore, this section builds from the Treasury's previous advice, and outlines some thinking on the principles, options and trade-offs that Ministers will need to consider in making long-term climate policy commitments. All of this advice will need to be further developed and tested with relevant Government agencies, and to be revisited in light of advice from the Climate Change Commission on the same issues.

We recommend adopting a strategic approach to funding and financing the climate transition including long-term investment horizons, well developed investment criteria, and reasonable sequencing and prioritisation across budgets.

44. Funding and financing the transition to a low carbon, climate resilient economy and society is a significant challenge both due to the scale of investment required and the need to manage incentives created through Government intervention.

45. Budget 2021 is not the only significant budget for Climate investment over the coming years. There are several key milestones over the parliamentary term which will have significant funding and financing implications, as set out in the context at the beginning of this report.

The policy mix influences the overall costs and benefits of transitioning and changes the balance of who pays. Decisions on the balance of policy tools will be made across 2021 and 2022. The long term funding approach should align with these decisions.

46. The Government has choices on how it facilitates climate change mitigation and adaptation - between regulation, pricing, direct fiscal supports, or purchase of international units. Relatively more regulation and pricing will generally mean the private sector directly shares more of the burden of transition. Relatively more direct investment from the Crown will mean taxpayers are socialising the overall costs of mitigation and adaptation. The 'pace' of change influences whether the costs are felt more today or in the future by businesses, employees, and taxpayers.

47. There is no perfect balance between these tools. Different approaches will distribute costs and benefits differently, and a range of other contextual factors (e.g. the existing industrial structure, investment decisions by other countries etc.) will affect the optimal policy mix for New Zealand. However, given the scale of adjustment needed, it is likely that both significant Crown and private sector investment will be needed.

A funding approach needs to balance multiple outcomes and result in incentives for businesses, households and individuals that support the policy intent.

48. The Treasury has begun initial thinking on some investment principles that could guide mitigation and adaptation initiatives. These are indicative only and have not been agreed with other agencies where significant work is ongoing (e.g. MfE and DIA). A more fully developed set of investment principles should support decision making in Budget 2021 and beyond. Some principles that might be considered when investing in climate mitigation and adaptation initiatives include:

- **Investments should be well coordinated across agencies:** climate mitigation and adaptation will require investment across multiple portfolios. Investments should occur in a coordinated manner and be sequenced with the necessary policy work.
- **Investments should balance long-term funding commitment with fiscal flexibility:** making commitments may be useful for providing certainty about the Government's approach. However funding commitments (including contingencies or funding committed for spending in future years) - have opportunity cost. It is also important to be able to change the type of investment as more information becomes available, the landscape changes, or further public finance system tools become available.
- **There should be an agreed balance of burden between central government and the private sector / wider society:** the scale of investment required for climate mitigation and adaptation cannot be met by the government or the private sector alone.
- **Enabling a just transition:** the transition to a low-emissions climate resilient economy and society will involve substantial change. It is a Government priority to facilitate a smooth transition.
- **The Crown should recover costs, where possible / appropriate, from those who benefit from investments (the benefit principle):** in general, the people who benefit from a particular investment should proportionally meet the costs of those investments. Similarly, those who increase societal costs through emissions should bear those costs. This can align incentives to facilitate transition, but can also have undesirable distributional impacts. The Crown may need to manage these impacts to support other goals and maintain social licence.
- **The Crown should provide as much information as possible to improve certainty while reducing moral hazard:** it is important to maintain the right incentives for private actors to manage the risks they face and make good decisions. Moral hazard can occur where asset owners take on more risk than

they otherwise would have because someone else is sharing the cost should the risk eventuate.

- **Reduction of long-run costs:** through taking a whole-of-life approach to investment decisions.

Additional principles for investment in adaptation.

- **There should be an agreed balance of central vs. local government roles and responsibilities:** The benefit principle suggests that for investments in adaptation, in general central government should not bear the full costs, as most benefits will be at the property owner and local community level. However, there are situations where national-level benefits and costs may justify central government investment (or co-investment).
- **The Crown should support vulnerable communities:** government should prioritise support where natural hazards converge in areas where communities may struggle to pay, individually or collectively, for the costs of managing or bearing disaster risk.

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a. [33]

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Annex One: Talking Points

General talking points to steer discussion

- What are your highest priority initiatives for climate change in Budget 2021 and later Budgets this term?
- How are you thinking about linkages between your portfolios and how can they work together to achieve the Government's climate objectives?
- How do you see your climate related initiatives contributing to the Government's wider economic and social objectives?

General Budget 2021 talking points

- The approach to Budget 2021 will require greater discipline. Given the constrained fiscal environment, there will be a high bar for new spending and it is important that spending is prioritised effectively and focus is placed on achieving value for money.
- To maximise progress on the change we want to deliver, we need to shift focus and resources towards targeting the drivers of wellbeing that matter most to New Zealanders.
- New spending is not the only lever for achieving the Government's objectives. You should consider all the levers available to you before requesting new funding, including examining baseline expenditure, ensuring that your agencies are delivering on the significant investments we have already made, and progressing non-spending initiatives such as regulatory reforms.
- As agreed by Cabinet, the Priorities for Budget 2021 are:
 - Continuing the COVID-19 response;
 - Delivering priority and time-sensitive manifesto commitments;
 - Supporting core public services through managing critical cost pressures and manifesto commitments; and
 - Continuing to deliver on existing investments.
- In contrast to previous Budget processes, only Ministers who I have invited will be able to submit initiatives for consideration through Budget 2021. These initiatives will be limited to critical cost pressures and the highest priority manifesto commitments.
- In addition to the letter you recently sent me and Minister Woods, today is an opportunity for you to outline the cost pressures and manifesto commitments you expect to face in your portfolio over the next three years. We have three Budgets to meet our commitments, so I encourage you to make a strong case for why I should invite you to submit these for consideration through Budget 2021.

Annex Two: Manifesto Priorities, Cost Pressures and Other Initiatives

Note: In the time available, the Treasury has not been able to reach a definitive view on whether it would be appropriate or not to invite all the climate change initiatives from Ministers into the Budget 2021 process. So judgements in this Annex should be read as tentative, and are provided to inform your initial discussion with Climate Ministers.

Portfolio	Bid type	Initiative	Indicative cost over four years	Initial Vote team comment
Climate Change	Cabinet paper	Implementation of the Carbon Neutral Government Programme	TBC	This is not a manifesto commitment. It is likely that this initiative can be deferred or phased.
		[33]		
	Cost pressure	Climate change commission (CCC) capability	[33]	We consider that this meets the definition of a critical cost pressure. CCC are facing cost pressures in contracting and delivery of emissions forecasts and other advice.
		Addressing cost pressures for the Ministry for the Environment	[33]	We consider that this meets the definition of a critical cost pressure. This initiative seeks capability and capacity pressure funding for key climate-related MfE work streams, including the government's contribution to He Waka Eke Noa and the development of an Adaptation Act. There will be phasing and scaling options available.
[33]				
Energy and Resources	Manifesto commitment	[33]		
		EECA Business Support Programmes	\$13.6m	Manifesto commitment. It is likely that this initiative can be deferred or phased.
		Increasing the Low Emissions Vehicles Contestable Fund	\$25m	Manifesto commitment. It is likely that this initiative can be deferred or phased.
	[33]			
N/A	[33]			
	Warmer Kiwi Homes Programme	[33]	It is likely that this initiative can be deferred or phased. The programme is currently due to run out of funding late October 2021.	
Environment	Manifesto commitment	[33]		
		Environmental Monitoring and Reporting System	[33]	Manifesto commitment. This initiative seeks funding for key data and monitoring work streams within MfE. There will be phasing and scaling options available.
	N/A	[33]		
Transport	Manifesto commitment	[33]		
		Clean car standard	\$28.7m opex \$16.2m capex	Manifesto commitment. This initiative has relevance due to potential emissions reduction. It is unlikely that this initiative can be deferred.
	N/A	Clean car discount scheme	\$36.6m capex	This is not a manifesto commitment. It is likely that this initiative can be phased.
		Modified clean car discount	\$265m capex	This is not a manifesto commitment. It is likely that this initiative can be phased.
		[33]		

		[33] Biofuels mandate	\$6m opex	
		[33]		
	Cost pressure	Future of Rail – Rolling Stock and Mechanical Depots Investment to Support a Resilient and Reliable Rail Freight System	[33]	Cost pressure. There is some time sensitivity due to age of assets and long lead time for investment and procurement. Related to manifesto commitment to make the freight network more sustainable.
		Future of Rail – Crown contribution to network investment – LTMA	[33]	
		[33]		
		Future of Rail – Investment in improved resilience and reliability of core assets	[33]	
		[33]		
Agriculture	Manifesto commitment	Increase to Agricultural Climate Change Research	[33]	Manifesto commitment. Time sensitivity. High relevance. The value of research investment is dependent on timeliness. Deferring support lowers returns.
		Integrated Farm Plans	[33]	Manifesto commitment. Time sensitivity. High relevance. Delays in funding would result in delays in outcomes for climate change and implementing Action for Healthy Waterways
Other Portfolios	Manifesto commitment	Research, Science and Innovation: Increasing investment in world-leading research that will reduce emissions	N/A	N/A (specific information will be provided later).
		Housing and Urban Development: Supporting energy efficiency in housing through mandatory energy efficiency certificates		
		Housing and Urban Development: Amending the Building Act 2004 to deliver better building consenting and continue with the Building for Climate Change work programme		
		Economic and Regional Development: Expanding the Just Transitions Unit work programme		
		Forestry: Empowering local councils to decide which land can be used for plantation and carbon forests through the resource consent process		
		Education: Installing energy efficient heating and lighting		
		Foreign Affairs, Trade: Agreement on climate, trade and sustainability		
		Immigration: Ensuring immigration includes consideration of climate-related migration policies		