

The Treasury

Budget 2022 Information Release

August 2022

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Reference: T2022/557 SH-10-8-6

Date: 14 March 2022

To: Minister of Finance (Hon Grant Robertson)

Deadline: 15 March 2022, 8.45pm
(if any)

Updated Climate Emergency Response Fund package following Budget Ministers 4

On 9 March 2021 you had your fourth meeting with Budget Ministers concerning Budget 2022. At that meeting, a number of changes were made to the draft Climate Emergency Response Fund (CERF) package.

This Aide Memoire outlines how we have reflected these changes in the draft package, and identifies outstanding changes for discussion at your meeting with Minister Shaw on 15 March, ahead of Budget Ministers on 22 March.

We have attached two annexes for your information and for referral to Minister Shaw to support the conversation:

- A table showing the Climate CE “High Priority” package, changes made at Budget Ministers 4, and outstanding changes to be discussed at Budget Ministers 5, and
- An updated version of the emissions impact information associated with the package discussed at Budget Ministers 4, which was attached to advice on 7 March [T2022/429 refers]. We expect that this information will be of interested to Minister Shaw.

Changes made to the package

Four changes to the CERF package were agreed at Budget Ministers 4:

- The initiative *Reducing emissions from waste* [33]
- The initiative *Accelerating the decarbonisation of the public transport bus fleet* was added to the package at a cost of \$40.65 million operating over four years.

- [33]
- The initiative *Agriculture emissions reduction – supporting producers and Māori entities transition to a low emissions future* was reduced from \$63.73 million total operating to \$34.69 million operating over four years.

This reduced the CERF package from \$3.53 billion to \$2.38 billion total (operating over four years and capital over ten years). The new package is reflected in the attached Annex 1, along with proposed further changes that we recommend you discuss with Minister Shaw on 15 March and with Budget Ministers on 22 March.

Outstanding changes to be discussed with Minister Shaw and at Budget Ministers 5

There are a number of further potential changes to the package that were discussed at Budget Ministers 4.

- The draft package currently includes \$31.812 million for a trial of a vehicle scrappage scheme as a component of the initiative *Assisting low-income New Zealanders to shift to cleaner vehicles*. [33]
 - The trial option would see 2,500 cars being scrapped over 2022/23 and 2023/24. The full option would see an additional 45,000 scrapped over 2024/25 and 2025/26.
 - The Ministry of Transport has also outlined a medium option for consideration. This would involve a smaller trial (only 1,300 cars scrapped over 2022/23 and 2023/24), followed by a targeted roll out to key urban centres. This would lead to 22,500 cars being scrapped over 2024/25 and 2025/26, at a cost (trial and roll out) of \$293.062 million over four years.
 - Our advice remains that if Ministers wish to progress a scrappage scheme, funding a trial only would be preferable in the first instance, with review and evaluation before further funding is committed. This reflects a view from Treasury (and, we understand, from the Ministry of Transport) that there are substantial questions and risks to work through on the implementation and design of the scheme.
- At the meeting, there was some discussion about the funding for decarbonising buses, and whether this should be funded at \$40.65 million (Treasury recommended), [33]
 - Our recommendation was based on funding the replacement of all buses which have contracts coming up over the next three years. This would see

249 buses replaced from 2022 to 2025. After this point, we expect mandates will be introduced that would incentivise replacement without central funding being required.

- Replacing each bus incurs a fixed cost of \$55,000 over ten years, so this bid is scalable. It could be increased from our recommended option by replacing more buses and thereby extending the electric fleet. [33]

- [25]

- Finally, in discussion on *Delivering mode-shift and reducing VKT in New Zealand's main urban areas*, [34]
 - There is an initiative titled *Making public transport more affordable for low income New Zealanders* which sought \$61.62 million operating and \$2.28 million capital for a public transport fare subsidisation scheme targeted at Community Services Card holders. This initiative was not supported by Climate CEs or Treasury for two reasons:
 - A trial of the scheme is ongoing, and we recommend awaiting the outcomes of the trial before committing to full funding.
 - Early evidence suggests that price barriers tend not to be the reason for reduced public transport take up by low income households; instead this is likely driven by network issues like the frequency or location of public transport services. However, price could become more important as fuel costs rise.
 - If a decision is made to roll out this initiative nationwide (the existing trial only covers Auckland), Ministers may want to consider the implementation challenges associated with rolling out this initiative, given an initial trial is still ongoing.
 - Further, if you do wish to create behavioural 'nudges' toward public transport, funding additional buses through the bus decarbonisation initiative may be a way to do this, as we suspect that extending the electric fleet could lead to an extension of the bus network overall. However, there are some risks to this approach, it is unclear how much extension electric bus manufacture and supply lines could support in the immediate future.

These potential changes are outlined in Annex 1. If agreed, they would increase the size of the CERF package to **\$2.56 billion operating over four years, and \$194.5 million capital, for a new total of \$2.75 billion, up from \$2.38 billion.**

Annex 1 also indicates where we will seek to update costs for some initiatives based on developments since bids were submitted, ahead of Budget Ministers 5:

- Match CERF overhead costings for the Ministry for the Environment to the updated Natural Resources Cluster (NRC) package. We expect this to reduce costs within the CERF package.
- Update the costs for *Emissions Reduction Plan Performance Monitoring*. These costs were a placeholder pending Ministerial decisions. They can now be updated to reflect the Cabinet decision to establish an Interdepartmental Executive Board, [33] We expect this to reduce costs overall.

Managing ongoing funding in the CERF

On 7 March, we advised you that the Climate CE “high priority” package implied up to \$439 million per annum of ongoing operating funding [T2022/429 refers]. In that report, we committed to providing you with options to scale this funding back should that be your preferred approach to managing these costs.

Following some clarification of outyear funding sought by agencies, and changes made at Budget Ministers 4, we expect that outyear costs in the CERF will be closer to \$250 million per annum on average over 15 years. However, this still presents an affordability challenge.

We have previously advised that these costs be charged against the CERF, using a forecast horizon of 15 years. Charging \$250 million per annum of outyear costs, in addition to the CERF package as at Budget Ministers 4 (\$2.4 billion operating and capital, over 4 and 10 years respectively) would come to a total of \$5.12 billion.

We are interested in your preferences for managing these costs, which we could reflect in the Budget Ministers 5 materials. As noted previously, the basic options are to:

- reduce the level of outyears funding required by scaling or time limiting funding,
- allow these costs to impact the fiscal indicators directly, or
- extend the time horizon of costs that are charged against the CERF.

We are investigating further where outyear costs could potentially be reduced. We think the most reasonable options are likely to be in some of the agriculture and forestry initiatives, which currently have some of the most significant outyears funding and some discretionary components.

If you increased the CERF by \$750 million (ETS cash proceeds as at MBU), its **total available funding after the international climate finance pre-commitment will be \$4.41 billion**. This would require outyears funding of no more than \$185 million a year for the package to fit within the balance, based on charging 15 years of costs.

However we would also note that ETS prices have recently dropped, so the final amounts available from ETS proceeds are not certain at this stage, and this would mean leaving minimal funding remaining in the CERF.

Emissions impacts of these changes

On 7 March, we provided you with advice showing the potential emissions impact of the CERF package proposed for discussion at Budget Ministers 4. We have included an updated version of this as an annex to this Aide Memoire, and recommend referring it to Minister Shaw ahead of your meeting.

We have updated the table after identifying two small errors in the original annex. One was the inclusion of estimated abatement of 90Kt (or 0.09Mt) for the initiative *Accelerating the decarbonisation of freight transport*. This figure is the abatement potential for another initiative (specifically, *Accelerating the decarbonisation of the public transport bus fleet*). We have also identified another small double-counting error for the impact from the scaling proposed at Budget Ministers 4 for the initiative *Delivering mode-shift and reducing VKT in New Zealand's main urban areas*. The prior annex appropriately reflected the impact of the proposed scaling on the abatement potential of the Climate CE 'high priority' package, but its impact on the gap to meeting the first emissions budget was incorrectly calculated.

Making these amendments corrects the estimated gap at Budget Ministers 4 from 0.68Mt to 0.83Mt.

We estimate that making the additional changes described in this note for discussion with Minister Shaw and at Budget Ministers 5 will decrease the gap to meeting our first emissions budget from 0.83Mt at Budget Ministers 4 to 0.8Mt (including the changes agreed at Budget Ministers 4). We will reflect this in the Budget Ministers 5 material.

Key messages for discussion with Minister Shaw

We recommend that you raise the following at your meeting with Minister Shaw:

- Budget Ministers are now considering a draft package of \$2.18 billion operating and \$192 million capital for the CERF. This is outlined in Annex 1.
- The Treasury has worked with the Ministry for the Environment to estimate the impact of scaling on expected emissions abatement. The rough estimate is that the package agreed at Budget Ministers 4 would lead to a gap of 0.83Mt to meeting our first emissions budget.
- At the next meeting of Budget Ministers, the following potential changes to the package will be discussed:
 - [33]

- Whether to fund the initiative *Accelerating the decarbonisation of the public transport bus fleet* at either \$40.65 [33] operating.
 - Whether to fund the initiative *Making public transport more affordable for low-income New Zealanders* at a cost of \$61.62 million operating and \$2.28 million capital.
- These changes would reduce the gap to meeting our emissions budget slightly to 0.8Mt.
 - We do not consider that there are substantial further opportunities to reduce the gap through the CERF in Budget 2022. Most of the scaling in the CERF package has been to mitigate delivery risk, so increasing funding is not likely to lead to material abatement gains.
 - The March Baseline Update (MBU) indicates that an additional \$750 million of ETS cash proceeds will be included in the Budget Economic and Fiscal Update, relative to the Half-Year Economic and Fiscal Update. This MBU figure was based on a New Zealand Unit (NZU) price of \$75.25, and will be included in preliminary fiscal forecasts, which you will receive on 21 March.
 - ETS cash proceeds will then be updated in the final fiscal forecasts, likely based on the 31 March New Zealand Unit price. We note that since the MBU changes, the NZU price has fallen from \$75.25 to \$72.50. We will update you on the impact of this price change when you receive final fiscal forecasts in the first week of May.
 - We recommend you discuss your thinking on topping up the CERF and its outyear funding implications with Minister Shaw.

After your meeting with Minister Shaw, we will incorporate any changes to the package to the draft slides for Budget Ministers 5, which you will receive on 16 March.

Katie Collier, Analyst, Climate Change, [39]
 Nicky Lynch, Manager, Climate Change

Annex 1: Budget 2022 Draft Climate Emergency Response Fund Package

To inform discussion with Minister Shaw on 15 March 2022

	Climate CE “High Priority” Package (\$m)		Changes agreed at Budget Ministers 4 (\$m)		Outstanding changes after Budget Ministers 4 (\$m)		Notes
	Opex total	Capital	Opex total	Capital	Opex total	Capital	
Agriculture, Biosecurity, Fisheries and Food Safety							
Agriculture emissions reduction - Developing the He Waka Eke Noa pricing system (phase one)	6.28	-	-	-	-	-	
Agriculture emissions reduction - Accelerating development of greenhouse gas mitigations	338.75	-	-	-	-	-	The outyear funding for this initiative could be reduced, to avoid high outyear costs against the time limited funding available in the CERF.
Agriculture emissions reduction - Supporting producers and Maori entities transition to a low emissions future	[33]		34.69	-	-	-	[33]
Business, Science and Innovation							
Electricity market measures to support the transition to a highly renewable electricity system	5.23	0.06	-	-	-	-	
Funding further decarbonisation of industry and heat and implementing supporting policies	677.25	0.57	-	-	-	-	
Equitable Transitions Programme	16.32	-	-	-	-	-	
Environment							<i>We intend to align the approach to funding Environment overheads in the CERF with the approach in the Natural Resources Cluster ahead of Budget Ministers 5.</i>
Māori Climate Action	32.27	-	-	-	-	-	
Delivering New Zealand's international climate change target through offshore mitigation	10.87	-	-	-	-	-	
Enable a scaled-up, high quality Voluntary Carbon Market	4.49	-	-	-	-	-	
Reducing emissions from waste	[33]	-	[33]	-	-	-	At Budget Ministers 4, it was agreed that this initiative should be funded at the Treasury recommended level, with any remainder being met from the Waste Levy.
Emissions Reduction Plan Performance Monitoring	27.09	-	-	-	-	-	
Forestry							
Increasing woody biomass supply to replace coal and other carbon intensive fuels and materials	29.47	61.59	-	-	-	-	The outyear funding for this initiative could be reduced, to avoid high outyear costs against the time limited funding available in the CERF.
Establishing native forests at scale to develop long-term carbon sinks and improve biodiversity	64.61	80.35	-	-	-	-	The outyear funding for this initiative could be reduced, to avoid high outyear costs against the time limited funding available in the CERF.
Maximising carbon storage: increasing natural sequestration to achieve New Zealand's future carbon goals	62.90	49.00	-	-	-	-	The outyear funding for this initiative could be reduced, to avoid high outyear costs against the time limited funding available in the CERF.
Transport							
Delivering mode-shift and reducing VKT in New Zealand's main urban areas	[33]	-	374.55	-	-	-	
Assisting low-income New Zealanders to shift to cleaner vehicles	334.16	-	-	-	627.22	-	At Budget Ministers 4, Ministers requested information on an option between a trial and a full roll out of vehicle scrappage. This option would target key urban centres and can be discussed at with Minister Shaw on 15 March and at Budget Ministers 5.
Accelerating the decarbonisation of the public transport bus fleet	-	-	40.65	-	[33]	-	This was agreed for the package at \$40.65 million. [33]
Accelerating the decarbonisation of freight transport	20.116	-	-	-	-	-	
Making public transport more affordable for low income New Zealanders	-	-	-	-	61.62	2.28	This initiative was discussed at Budget Ministers 4, and we recommend you discuss its potential inclusion with Minister Shaw on 15 March and at Budget Ministers 5.
PACKAGE TOTAL	[33]			192.22	[33]	194.50	

Note: not all initiatives seeking CERF funding are represented above; this table only shows initiatives currently in the draft package.

Covering Note

“This Annex was created based on emissions abatement information provided to the Treasury by agencies supporting the development of the Emissions Reduction Plan (ERP). Since the provision of this information, additional work has been undertaken by those agencies to progress the estimation of the abatement potential of ERP policies and measures, including those supported by initiatives that sought funding through the Climate Emergency Response Fund in Budget 2022. We understand that this ongoing work has resulted in some abatement estimates having changed significantly since the initial information was provided to Treasury to support this advice. The final estimates for abatement of ERP policies and measures are being proactively released through a separate process. Due to the work undertaken to update estimates and the imperfect mapping between ERP actions and CERF initiatives, it is likely that the abatement information released through that process differs from the information as presented in this Annex.”

Annex 2: Impact of original Climate Change Chief Executives' "High Priority" package proposed scaling on emissions quantification

Initiative ID	Title	CE package status	Original abatement estimate of funding sought (EB1) Kt	Estimate of abatement under the CE 'high priority' package (EB1) Kt	Impact of CE 'high priority' package on the estimated "gap" to meet EB1 (Kt)	Comment on the impact of scaling or deferring funding on EB1	General comment
13814	Funding further decarbonisation of industry and heat and implementing supporting policies	High Priority - Full	1604	1604	0	Fully funded in the 'High Priority' package. All estimated abatement is assumed to be achieved.	
14058	Agriculture emissions reduction - Accelerating development of greenhouse gas mitigations	High Priority - Full	420	420	0	Fully funded in the 'High Priority' package. All estimated abatement is assumed to be achieved.	
14062	Maximising carbon storage: increasing natural sequestration to achieve New Zealand's future carbon goals	High Priority - Scaled	387	387	0	Quantified emissions component seems to be fully funded and so all estimated abatement is assumed to be achieved.	
[33]							
13827	Delivering mode-shift and reducing VKT in New Zealand's main urban areas	High Priority - Scaled	130	60	60	Emissions impact has been scaled proportional to how funding has been scaled in the 'High Priority' package. Scaling has a negative impact on the total abatement potential of the Climate CE 'high priority' package. However, because Transport initiatives have not been included in the 'adding up' exercise to calculate the estimated "gap" to meet EB1, any abatement achieved from funding Transport initiatives through B22 will help close the "gap".	The estimated abatement impact of this bid is significantly greater in EB2 and EB3. Scaling the bid would therefore have implications for abatement quantification beyond EB1. However, there is significant delivery risk associated with the majority of funding being sought by this initiative. This creates significant uncertainty that the estimated abatement in any budget period would be able to be achieved as modelled, regardless of how much funding was allocated to the initiative. Despite this delivery risk, MoT expects this bid to target investments that can be delivered quickly and are not 'infrastructure' heavy. They also expect to mitigate delivery risk through incentives placed on access to funding (e.g., 'use it or lose it' clauses for councils).
14059	Agriculture emissions reduction - Supporting producers and Māori entities transition to a low emissions future	High Priority - Full	120	120	0	Fully funded in the 'High Priority' package. All estimated abatement is assumed to be achieved.	
13840	Accelerating the decarbonisation of the public transport bus fleet	Expansion	90	0	0	Not in the 'High Priority' package- abatement associated with these initiatives is assumed to not be achieved.	
13839	Assisting low-income New Zealanders to shift to cleaner vehicles	High Priority - Scaled	22	8	8	Emissions impact has been scaled proportional to how funding has been scaled in the 'High Priority' package. MoT notes that the impact may be greater. However, because Transport initiatives have not been included in the 'adding up' exercise to calculate the estimated "gap" to meet EB1, any abatement achieved from funding Transport initiatives through B22 will help close the "gap".	

[33]

14248	Reducing emissions from waste	High Priority - Scaled	17	17	0	The impact of the proposed scaling in the 'High Priority' package is uncertain. However, it is assumed that the proposed scaling will not impact the achievement of the estimated abatement in EB1.
13837	Making public transport more affordable for low-income New Zealanders	Expansion	14	0	0	Not in the 'High Priority' package- abatement associated with these initiatives is assumed to not be achieved. Because Transport initiatives were never included in the calculation to estimate the "gap" to meeting EB1, not funding this initiative has no abatement impact on the "gap".
14057	Increasing woody biomass supply to replace coal and other carbon intensive fuels and materials	High Priority - Scaled	12	12	0	Quantified emissions component seems to be fully funded and so all estimated abatement is assumed to be achieved.
13828	Building a sustainable skilled workforce to support upscaling of bus networks	Not high priority	3	0	0	Not in the 'High Priority' package- abatement associated with these initiatives is assumed to not be achieved. Because Transport initiatives were never included in the calculation to estimate the "gap" to meeting EB1, not funding this initiative has no abatement impact on the "gap".
[33]						
Total (Kt)			3405	2628	-516	The impact of the scaling and deferring of funding as recommended by the Climate CE's 'high priority' package is anticipated to increase the estimated "gap" to meet our first emissions budget from 0.3Mt to 0.816Mt
Total (Mt)			3.405	2.628	-0.516	

Impact of changes agreed at Budget Ministers 4						
Initiative under consideration		Proposed change	Impact of change on estimate of abatement under the Climate CE 'high priority' package (kT) in EB1	Impact of change on the estimated "gap" to meet EB1 (Kt), as compared to the "gap" under the Climate CE 'high priority' package	Comment on the impact of scaling on the Climate CE package	Comment on the impact of scaling on the estimated "gap" to meet EB1 (Kt)
14248	Reducing emissions from waste	Reduce to [33]	0	0	The impact of the proposed scaling is uncertain. However, it is assumed that the estimated abatement in EB1 is unlikely to be significantly impacted, as the intention is to use other revenue sources.	No anticipated impact
13840	Accelerating the decarbonisation of the public transport fleet	Include \$40.65m	90	90	While initiative is not fully funded, the proposed scaling of the initiative is not anticipated to have an impact on its estimated abatement potential in EB1.	Transport initiatives were never explicitly included in the "adding up" exercise to calculate the "gap" to meeting our first emissions budget. For this reason, any abatement anticipated to be achieved by funding B22 Transport initiatives is assumed to close the "gap" to meeting our first emissions budget.
13827	Delivering mode-shift and reducing VKT in New Zealand's main urban areas	Reduce to \$374.55m	-44	-44	The impact on the estimate of abatement anticipated to be supported by this bid has been scaled proportionally to the amount that is recommended to be funded. Further scaling beyond the Climate CE 'high priority' package recommendation results in a decrease of 44Kt to the overall abatement potential of the CERF package.	After further scaling, this initiative is anticipated to deliver 16Kt. This is 44Kt lower than the anticipated abatement under the CE 'high priority' scaling therefore the BM4 adjustment will widen the gap as estimated under the Climate CE 'high priority' package by 44Kt.
14059	Agriculture emissions reduction - Supporting producers and Māori entities transition to a low emissions future	Reduce to \$34.69m	-55	-55	The impact of the estimate of abatement anticipated to be supported by this bid has been scaled proportionally to the amount that is recommended to be funded. The recommended scaling results in a decrease of 55Kt to the overall abatement potential of the CERF package.	Scaling this initiative is expected to have a direct impact on widening the "gap" to meeting our first emissions budget by 55Kt.
Total impact of suggested changes compared with Climate CEs high priority package (Kt)			-9	9	The impact of the suggested changes to the CE 'high priority' package is anticipated to decrease the estimated abatement potential of the Climate CE 'high priority' package by 0.009Mt.	The impact of the suggested changes to the Climate CE 'high priority' package means that the Climate CE 'high priority' package with the suggested changes is anticipated to further increase the estimated "gap" to meet our first emissions budget from 0.816Mt to 0.825Mt. The suggested changes therefore marginally widen the "gap", compared to the Climate CE 'high priority' package without these changes.
Total impact of suggested changes compared with Climate CEs high priority package (Mt)			-0.009	0.009		