

## A Climate for Protection Money

**The plan to put a price on carbon emissions needs to change or it will require ordinary consumers to pay for protection of farmers' capital gains and fail to meaningfully cut the nation's emissions.**

The simplest way to understand the Government's central response to climate change is to think in terms of protection money.

The Emissions Trading Scheme (ETS) starts in the right place - setting up a mechanism to put a price on 'carbon'.

Such a price signals the cost of emissions to the environment, encourages low carbon alternatives, and has the capacity to reduce emissions. Climate Protection Money is the other benefit, as pricing also brings in funds to meet the nation's Kyoto commitments.

New Zealand's gross emissions are expected to be 28% over its Kyoto Protocol target without intervention. To square away this excess and do its bit for climate protection, New Zealand will buy carbon credits from overseas and the ETS will ensure local forest owners who remove carbon from the atmosphere also get paid.

So far so good. Now for the problems. The first is that, in its current form, the ETS will not do anything meaningful for the biosphere any time soon. Less than 2% of gross emissions would be cut during the first five years.

The other linked problem is that the ETS is extraordinarily inefficient and unfair in the way it allocates the Kyoto bill. Households, road users, and small and medium businesses, that generate one third of the nation's emissions, will meet 90% of the payments required before 2013 as a result of the ETS.

That's because the small guys are subsidising the major industrial emitters and pastoral farmers. The subsidies are massive and it will be 2019 before this protection even begins to fade out.

Industry Protection Money comes in two forms. Part of the subsidy smooths what could otherwise be a sharp transition for major emitters, especially those whose competitors are in countries not subject to Kyoto obligations. However a 90% average level of protection for 11 years on their emissions and increases in power prices is clearly excessive. It will cost well over \$1.4 billion at current carbon prices of \$30/tonne, with more than 70% of this to cover power price rises caused by the ETS.

A few businesses could require significant protection but most of the total handed out will be Profits Protection Money. Far less would keep the businesses open and employing the same people but the proposed fund for this corporate welfare is not means-tested.

Agricultural Protection Money is a much greater sum however. The complete exemption of agricultural emissions during the first five years involves a net subsidy of \$1.3 billion, compared to what the sector would pay if charges were set in

proportion to its emissions. For the six years following, the subsidy level is still so high that there will be another wealth transfer of similar magnitude.

Again there is a good argument for transitional assistance but, unlike some major emitters, there is no risk of agriculture's prime asset closing down or moving offshore. What is ultimately at stake is reduced value of this land, not the existence of farming itself as some farming lobbyists have mooted.

Dairy farmers have seen their wealth grow dramatically with average prices per hectare soaring from \$14,658 in 2002 (when the Protocol was ratified) to \$30,599 in late 2007. Adjusted for inflation, this has delivered tax free capital gains of 83%. If the cost of agricultural emissions were passed through to dairy farmers in full, this would equate to \$220/hectare a year (at \$30/tonne), or about \$2,000 if capitalised over 30 years at a discount rate of 10%.

So in the extreme case that dairy farmers paid for all their emissions from tomorrow with no assistance and made no emission reductions, then capital gains since 2002 would be reduced to 71%. Under the same scenario, sheep and beef farmers would see a 134% gain after the charges, but may face a change of land use.

What the ETS proposes is that non-farming families pay a vastly disproportionate share of the Kyoto bill to fund Capital Gains Protection Money to insulate pastoral farmers.

Yet unfairness is only part of the problem. The bigger picture is that insulating agriculture tosses away New Zealand's best chance to seriously cut emissions.

A consultant study completed for Government estimates that 60% of all emissions that could be saved for less than \$30/tonne are agricultural. Further, the five techniques it documents for cutting emissions – such as applying nitrification inhibitors – would actually boost farmers' profits today. Without a carbon charge to incentivise uptake, these opportunities to benefit the farm and reduce the nation's Kyoto bill will continue to lie fallow.

Looking further ahead, unless New Zealand starts cutting emissions now, it will soon face a new and much tougher target for emissions reduction (Kyoto II) and the bill for buying in carbon credits will be enormous.

Two bottom lines for change to the proposed legislation are:

- All sectors, including agriculture, begin taking financial responsibility for their emissions by 2010. Initial levels of responsibility are progressively ramped up at the same pace; and
- The legislation does not promise any subsidies after 2012, as it is too early to tell what would be appropriate.

The Prime Minister recently asked: "Who's serious about actually doing something about the climate change problem?" We will soon see if the minor parties have the ability to deliver serious progress, or the courage to walk away if there is to be no meaningful cut in emissions and the ETS simply redirects the Kyoto bill away from the politically powerful.

*Simon Terry is Executive Director of the Sustainability Council, and with Geoff Bertram co-authored "The Carbon Challenge". This article first appeared in a modified form in the New Zealand Herald on 23 July 2008.*