

NEWZTEL NEWS: RNZ "NINE TO NOON"

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(NTN A)

PRESENTER (KATHRYN RYAN): Well, what is the cost of New Zealand's commitment to the Kyoto Protocol which begins from next year? The Government has already announced one shock to the system, it revealed New Zealand's expectation of being half a billion dollars in credit during the first five year commitment period under the protocol, this based on our greenhouse gas emissions, suddenly turned into a half billion dollar deficit, a one billion dollar miscalculation by officials. Now, the Sustainability Council says on current market rates for the carbon credits we'll have to buy, that cost of Kyoto to the country would double again. The council's Chief Executive, Simon Terry, has waded through official documents to uncover what went on over the Kyoto cost blow-out and has crunched the numbers on what the country would have to pay at market rates today. This as officials have still to put up policies to fund the whole endeavour following the dumping of the so-called fart tax on agricultural emissions and just about every other policy the Government had been working on to meet the cost. Simon Terry, whose work is based on cabinet papers and other documents obtained under the Official Information Act, joins us now in the studio, good morning, welcome to the programme.

SIMON TERRY (CHIEF EXECUTIVE, SUSTAINABILITY COUNCIL): Good morning.

PRESENTER: So you've gone through these documents to try to piece together what happened over the Kyoto cost blow-out. What did happen?

TERRY: We started with an understanding that Kyoto was going to deliver a net benefit to the nation and as you pointed out, in May '05 we found out that in fact we're in deficit and that raised some questions as to just how things changed over the period. If we look first at that announcement in May '05, it wasn't terribly clear at the time just exactly why things had changed. The Ministry for the Environment talked about forestry assumptions having shifted, but there were two quite separate things going on. There were forestry projections that weren't right but among that also were just mis-estimates, data that was actually not processed properly, and if you go back over the numbers, what's really interesting there is that in this billion dollar turnaround from where we were making money to losing money, about... well, the biggest part of it in fact was to do with programmes that were announced at the time that were supposed to save us emissions, in other words things run primarily under EECA that would encourage energy efficiency and so forth. Where officials had first thought those would be worth about a ten percent reduction in total emissions, on review they turned out to be worth zero.

PRESENTER: So when the error was made public and there was that big upheaval in May 2005, what were we told about what had caused this dramatic revision in the figures? What was made public?

TERRY: The figures were made public in a detailed report and while the numbers there are all available if you crunch them, it wasn't immediately apparent what was really going on, and certainly when officials were drawn before the select committee, Parliament's Local Government Environment Select committee to answer about this, it took Nick Smith multiple goes to actually get officials to concede that the projections related to emissions forecasts, not just forestry plantings falling off, and... but they never got to the bottom of it. In fact it was these programmes that were put in place and presumed to be delivering gains to New Zealand that then on reflection were not being... you know, were not expected to deliver after all.

PRESENTER: So we're being told that this is because the benefits, the gains we're supposed to be getting out of forestry, aren't what we thought they were, and also wasn't there a suspicion that all of a sudden our emissions were going to be much higher than projected? That was actually misleading.

TERRY: There was a suggestion in the way that the tables were constructed... unless you take the tables apart and go back over all the figures and line up the spreadsheet the way I've been doing, it's not apparent just what has... you know,

what was happening, and it really didn't give people a good idea as to you know, why things had changed, and this is important later on which we'll talk about further, but just to be clear, what that was doing was really changing the whole grounds on which we'd based our policy and that was really important at that stage to better understand what was going on.

PRESENTER: So there's two errors. One is the miscalculations that were made public, but the second was this business that on the savings side we simply weren't going to be getting any results really?

TERRY: The expectations that those policies that were first announced in 2002 or before would deliver up to ten percent of savings, those were scotched, they were wiped out from the accounts and we couldn't expect that any more. But go back a period earlier because in 2002 there was a similar sort of jolt but it wasn't... it wasn't discussed publicly and it actually had a really significant bearing on what happened after. If you think of us ratifying in Kyoto in 2002, documents coming before Parliament setting out the numbers, what we expected, those documents projected a particular level that we had to meet, that's what was enshrined in our Kyoto target which is getting back to 1990 levels.

PRESENTER: We have to go back to... yes, so that whatever we were emitting in 1990 is what we have to get back to in other words?

TERRY: That's our Kyoto target. It's actually one of the best ones of any country, we did really well. We got a soft target and we got the inclusion of the forests, we actually came out there looking good, but we thought we were a lot better than we really were. What had actually happened, those numbers that were presented to Parliament carried a 40 percent over-estimate for methane which translated to an 18 percent over-estimate for the target as a whole. Now, what that means is that we had to actually cut a lot more to reach that target. Where it first looked that we'd only have to cut emissions by about ten percent to reach that target, once you reprocess it for the adjustments, in fact it's something closer to 25 percent. So all of a sudden the target that looked sort of relatively achievable, suddenly you know, was looking very tough.

PRESENTER: How are these mistakes happening?

TERRY: It's really unclear. The one in 2002, if you trace back all the spreadsheets that are filed with the United Nations, it looks like as I say, there was just a pure over-estimate on the methane emissions and somehow that... you know, that appears to be a maths mis-estimate.

PRESENTER: Has that affected the second mistake then, or the second revision of estimates at all as far as you can tell?

TERRY: That one seemed to be correct and is consistent right through now, but what was important is, if you think back to 2002, we'd signed up to Kyoto and then the question was okay, so what policy do we put in place to reflect that, and this was a period you'll recall when, you know, the fart tax campaign you mentioned and discussions with agriculture, with other major emitters were going on, and governments still thought we were in credit, that we actually had you know, enough credits to ease the pain for some of these sectors, and during those two or three crucial years it would be really interesting to know whether ministers would have actually acted differently had they understood what we finally learnt in 2005 that really you know, we weren't ahead, we didn't have that kind of leeway and I guess it focuses the mind more sharply on what was not good economics to start with. We shouldn't have been cross-subsidising different sectors, or planning to.

PRESENTER: When you talk about the savings side of the equation being a major factor here, that officials were very reluctant to admit, how could they get the savings so wrong? Or the lack of savings so wrong?

TERRY: There's scant documentation on the official record but it does suggest that some of the benefits were simply not modelled at all, in other words they were kind of assumptions about just what would come through, and others, the modelling you know, apparently wasn't done that well. But either way, you know, you can imagine officials sort of thinking oh well, you know, we can make

a certain amount, you know, we'll figure out later exactly how we'll get it through, but they really hadn't nailed it and when they came to look at it more closely, you know, the ability to bring forward those numbers, they decided in the end clearly it wasn't there because they scotched the lot in the 2005 report.

PRESENTER: Which leaves us asking really, how much information and does Parliament yet have the full story of what has gone on with these estimates and how solid they are now?

TERRY: Well I think as you know, the then minister's introduction to those 2005 accounts said, it does raise questions about the reliability of their accounting, that's for sure. But I think there's a bigger issue here which is why we started to crunch the numbers. It's that there is a big risk on the Kyoto numbers for the New Zealand economy, for New Zealand in general, and getting a handle on that this might really be a big risk, that it might be a big number, is actually important to thinking about the policy Government is now considering.

PRESENTER: Well, especially when it's due to kick in... our commitment is due to kick in from next year. So all right, the Government's revised its position on this first five year period of Kyoto and it's said we now accept that we've got a half billion dollar deficit here to be made up with... presumably to be made up by purchasing carbon credits. Is that \$600million figure which is the precise figure they use, is that still the likely cost?

TERRY: Well, just to go back a little bit on how you arrive at that figure, government is looking at 91 megatonnes of emissions being in excess of our Kyoto target. At the price they're assuming of \$15 a tonne that comes out at around \$1.36 billion, but then you've got to allow for the forestry credits. The forestry brings the net down to about 41 megatonnes and... around that 600 million, but it so much depends on that carbon price. If that \$15 a tonne moves significantly, so does the bill, and if you were to go to the European Exchange today and try and square up for that bill, you're talking about a price closer to \$30 a tonne, i.e. double what the Government is currently looking at. Now, the Government has a report from one particular consultant that it bases that \$15 figure on and that's fair enough in one sense, but you would think that a market such as the European one which is the largest trading market for these credits... although it's not a perfect market, one concedes that... it's the judgement of a whole lot of people who are looking at this and therefore the projection is, you know, \$30.

PRESENTER: So you're saying that based on today's market prices in that European market, the dollar cost would actually be what?

TERRY: We're talking about \$1.2billion at that point. Now, just to be really clear, that future carbon price could go anywhere. It's a very, very difficult thing to project. It could actually go down.

PRESENTER: Well, that's part of the problem. One might argue that once the trading system was fully active, perhaps that could see the cost of carbon go down, or the carbon credits go down, but we have no knowledge of which way it's going to go. Are there any indications of which way it will go by the time New Zealand is stumping up with the cash?

TERRY: It really is a great uncertainty. If you think about the factors involved, we know for example that people are a lot more concerned about reducing emissions than they were a year ago, that there is more pressure on governments to actually begin these things, so you'd think you were getting greater demand for those carbon credits. And we know that the European Commission isn't particularly worried until the price hits about NZ\$60 a tonne, i.e. four times what the Government is assuming, but on the other hand you've got to say this is so much influenced by the politics of what the future commitments will be and what the rules around it will be, it's really a crystal ball exercise so the Sustainability Council isn't predicting any particular figure. I mean, government has one in its books.

PRESENTER: But it's saying current rates are double what the Government is planning on?

TERRY: Absolutely.

PRESENTER: And theoretically it could go higher?

TERRY: It could go far higher.

PRESENTER: Is the cash price of carbon the sole cost of Kyoto?

TERRY: That's the other thing about New Zealand thinking about its way forward here. What we might pay out net in terms of having to purchase credits after the forests, that's just the cash cost. You've also got to look... you know, if you're really saying what is this costing the nation, you've got to go back and say what could we have done before this time to have reduced our bill, are there things that we could have put in place earlier that would have, you know, hedged our position better. I'm thinking here of things like a differential on the registration fee for cars so that the fuel efficient cars get a good registration fee, those that are not so well performing have to pay a higher one, thinking about getting forestry incentives going a lot earlier to have boosted those plantings so we had trees that were absorbing carbon a lot more than they will at the present.

PRESENTER: So you're saying that the impact of this miscalculation, initial miscalculation, even the one that the Government's admitted, has affected its formation of policy in response to the Kyoto commitment?

TERRY: You can't exactly read ministers' minds but there's a lot...

PRESENTER: If it knew earlier that it was heading for a deficit rather than a surplus, it may have focused minds a lot earlier?

TERRY: That's a supposition. You'd think that it would have changed the way the Government would have worked because it really was quite a shock to the system when that May '05 account arrived, and it's this that really, you know, prompts the thinking about how could we have done this better and don't we need to improve our systems.

PRESENTER: Well, you've mentioned cars there but are there other policies that you seem to be intimating that you think the agricultural debate might have gone differently?

TERRY: That was the big one in a sense because New Zealand has a very unusual emissions profile with half of our emissions accounted for simply by agriculture, and you know, as the protests around that period attested, you know, farmers were very wary of taking any share of the burden that might be derived, you know... or might be as a result of those extra methane emissions which are about 42 percent of the excess on current projections. If government had known that we were not going to have this surplus, which implicitly was being thought of as a sort of... the money from the trees, i.e. the credits from the

trees that the Government took, was implicitly and even explicitly in certain texts, thought of as a sort of a way of offsetting the agriculture, you wonder whether that debate wouldn't have gone differently.

PRESENTER: Well, that's the point we'll come back to actually because one minute the farmers get to own their sheep that emit but they don't get to own the carbon benefits of their trees. We'll come back to that. The thing about the debate over the fart tax was that that money was only ever to be the levy as it was initially... was supposed to be a voluntary levy, a contribution toward research, and actually what happened in the end is, the Government would say it got what it wanted in the end in terms of a contribution towards research from the sector, after the furore over the fart tax died down. Are you saying that agriculture's contribution should be much greater than that research levy?

TERRY: If you look at the Government projections of what agriculture would be costing the country based on the Government's assumed price of \$15, it's about \$575million so if agriculture isn't paying that kind of money, there's an implicit subsidy there from taxpayers.

PRESENTER: And what is the difference then if agriculture goes back into the equation before say the end of the first commitment period, what sort of difference would that make?

TERRY: What you'd be looking at then is some kind of a sharing so that all emitters paid a reasonable price. There's a lot of politics on how a price might first be set and how it might be transitioned to a full market price, but if one is simply looking to protect the taxpayer and have a price signal go through to emitters, then it makes sense that agriculture should be a part of the equation.

PRESENTER: You argue that the agriculture and the transport sectors are the winners out of the policy as it stands now, and let's face it, there's not much policy there at the moment. Do your figures that you've been looking through, back that argument?

TERRY: If you simply go off the current policies and the projections that are produced under the Environment Ministry, it's clear that the pricing measures as I think from non-pricing measures... and there are two quite different ways of getting it, reducing emissions, both are actually important, but it's... I think it's worth noting that when cabinet received a report, a major review of the whole policy scene about a year ago, it concluded quote "unequivocally that if New Zealand wished to pursue emissions reductions over the long term, a broad-based greenhouse gas price would be the most important part of any policy response" unquote. In other words, getting a price across all emissions across the economy, that's your fundamental for building...

PRESENTER: Including agriculture?

TERRY: Including.

PRESENTER: What role then the foresters, many of them farmers, the foresters who say they're being done out of the market value of the benefits their forests create, that the Government is pinching those credits? What role does that play in this scheme?

TERRY: This is a very vexed issue. If you go back to where... this is why understanding the history is important because if you go back to that first set of assumptions, it looked as though we were so close to being able to meet the Kyoto target without the forests, that's what government was thinking in committing internationally that we would do that without using the forest credits. When those numbers caved in, it then became clear the forests were going to be needed. The Government was always the one holding the credits and the question was whether it would devolve to foresters. Signals were given but government reviewed that in light of various things, not... I don't... I haven't been able to get clear from officials exactly what happened.

PRESENTER: It was the idea of a split wasn't there, some kind of partial split between the forest owner and the Government?

TERRY: Certainly there was talk of a proportion going through to forest owners, but there are liabilities associated with these forests as well and this is what makes it so tricky if you look at the different timings in which forest credits are earned and then later when they're harvested, and you have to pay out for when you actually take the trees out of the ground.

PRESENTER: But is there not a perverse effect right now, people cutting down trees instead of planting trees because of this?

TERRY: There are a number of perverse effects, some of those created by the protocol, some of those created by the current proposals or even fears about the proposals. What seems clear is that somehow we're going to have to get the forestry sector feeling as though when it invests it's going to get a reasonable return because we need those trees.

PRESENTER: The other matter is this, can it be said that landowners are responsible for the emissions of their sheep and yet don't get to have the benefits of what their trees are doing, emitting if you will on their land? It is a fundamentally illogical argument, isn't it?

TERRY: There are some very odd things for farmers who... you know, a dairy farmer who is emitting flat out on one side and has deliberately planted some trees pre 1990 on another part of his land and he's going to be... he's not going

to get any credits but he'll be penalised if he cuts the trees down. There are things that don't quite work. What we need to do I think... I think what this begins to highlight all the more is just unless we can go from a principled framework and clearly carry those principles through, you know, we're at risk of getting very suboptimal outcomes and that key principle is polluter pays and those who are doing good things get rewarded.

PRESENTER: Which is not what is currently happening vis-à-vis the forests, is it?

TERRY: The forests are really complicated. I still haven't done the spreadsheets to really work out how that might best be put forward but it's clear that the foresters are going to need some proportion... something more than what they're getting to feel confident in the industry to invest.

PRESENTER: Looking back over these numbers then and what you uncovered, the first over-estimations about methane, for example, then finding out in 2005 not only that they had to meet those much stricter targets but that what they thought they were going to get in savings had collapsed to nil, what does it tell you about where government policy should be going now? What are the solutions that they're supposed to be putting up to us very shortly?

TERRY: At the moment what's coming forward in documents is proposals that the stationary energy sector, that is not just power generation but plants using gas and coal and so forth, that they will definitely receive a price signal, but that's only 23 percent of our total emissions. Transport is definitely outside, and while there are theoretical proposals to actually have pricing for agricultural emissions, those, you know, ministers are not talking as though those are very likely prospects at all. So we've got a very narrow base which people are talking about pricing carbon on, and a suggestion that there will be no across-the-board pricing until 2012. That's way too far out. This economy needs time to adjust and get serious about pricing carbon because the world is increasingly serious about this.

PRESENTER: Well, what about this business of what we are going to end up having to pay and trying to get some kind of control in limiting what we might have to pay in what is an unpredictable market? As you say right now the current price indicates that their estimates are out by 100 percent. What can be done to protect against that variability in the market?

TERRY: There... once the price signal goes through I think you'll see individuals who are responsible for those emissions really looking much more carefully at their operations. I think... I mean one of the myths that has been around is that agriculture doesn't have any real options to save emissions. Methane may be tough although there are even signs there that that may be getting better, but

the other theory of agricultural emissions are things called nitrous oxides and there are some very interesting products that have come forward that, while they still need some environmental assessment, they have, you know, potential to save between 50 and 75 percent of emissions.

PRESENTER: But if we've got to buy on that market, there's no way we can hedge... you wouldn't want to hedge now, the price that's there now, but there's no way we can hedge now against the future cost of it?

TERRY: You can pay for hedges. I mean there's... you know, if you went out and started buying on the European market now, and Treasury has even talked about buying some advance credits... but because of the huge uncertainty you don't know whether you're actually going to be doing the country a favour or not, buying early. Logically if the world decides that climate change really needs to be taken seriously, we really need to cut emissions, you'd expect to see you know, some tightening of the market but we still don't know in a sense...

PRESENTER: What does that do to price?

TERRY: That should bring price up but the caveat always is, we don't really know because we haven't pushed very hard on finding out just how cheap it is to save. Often, you know, you can find that it's actually cheaper to save than you think.

PRESENTER: Well, except that the savings effort here has come out at zero.

TERRY: Well, the effort hasn't been particularly great.

PRESENTER: How ready are we now, judging from these papers that you've been through... with the first commitment period beginning next year, how ready are we now to meet our obligations under that first commitment period to Kyoto?

TERRY: We've used up an awful lot of time that we could have been putting measures in place and that's really left us with rather little to go on. To that extent, you know, we don't have the kind of things that we would think we might have had in place by now. What we're looking... our best defence at this point is to take the view that we want to take... set a principled pricing for all things and then we want to engage our people who are exporting, to go for those premium ends of the market, to turn threat to opportunity and to begin to produce the most sustainable products we can.

PRESENTER: By 2008, indeed. Simon Terry, thank you very much for that and the work that you have done on those cabinet papers and other documents under the OIA. We should say that we approached the ministry... the Minister for the Environment. He declined to appear. Government policies are of course due I think in May, the next lot of them anyway, the next proposals due out in May.

The Ministry of the Environment also declined to appear today, saying that they wanted to look through the numbers before commenting further.

ENDS <24:00>