

# The Treasury

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### Cabinet Document Details

Title: **Cabinet Paper: CBC-21-SUB-0060: Developing an Approach to Funding and Financing the Climate Transition**

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Office of the Minister for Climate Change

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Office of the Minister of Finance

Office of the Minister of Climate Change

Cabinet Business Committee

## **Developing an Approach to Funding and Financing the Climate Transition**

### **Proposal**

- 1 This paper seeks agreement to a work programme that will generate recommendations on how to fund and finance Aotearoa New Zealand's just transition to a low emissions and resilient economy. This work will focus on:
  - 1.1 Identifying methods to ensure clarity and certainty of public finance for adaptation and mitigation activities, including:
    - 1.1.1 fiscal management tools (such as making commitments to the source and scale of climate related funding)
    - 1.1.2 budgeting mechanisms (such as decision making processes and structure of Votes)
    - 1.1.3 assessment and monitoring tools (such as shadow carbon pricing and climate impact assessments) to support the alignment of public spending decisions and climate policy objectives.
  - 1.2 Developing a preferred institutional arrangement to accelerate the mobilisation of private capital to fund adaptation and mitigation projects.
- 2 The proposed work programme will make recommendations by October 2021 to underpin the Emissions Reduction Plan (ERP). These will then inform Budget 2022 decisions (and influence subsequent budgets). Further work will be required following Budget 2022 to underpin the National Adaptation Plan.

### **Relation to government priorities**

- 3 This relates to the Government's priority on addressing climate change, and its overarching approach to consider climate change in all of the government's work. The 2020 Speech from the Throne identified the global climate crisis as one of the country's three longest-standing and hardest issues demanding continued and determined action. It also relates to the Cooperation Agreement between the Labour and Green Parties, regarding the common goal of "achieving the purpose and goals of the Zero Carbon Act."

- 4 The Government declared a climate change emergency on 2 December 2020, with the Cabinet Business Committee (CBC) agreeing that climate change “demands a sufficiently ambitious, urgent, and coordinated response across government to meet the scale and complexity of the challenge” [CBC-20-MIN-0097 refers].

## **Executive Summary**

- 5 In December 2020, the CBC invited a report back on a strategic framework for funding and financing the climate transition, including the role of proceeds from emissions unit auctions [CBC-20-MIN-0126]. This paper provides that report-back, updating on actions and decisions taken so far, and proposing a work programme leading up to Budget 2022.
- 6 New Zealand’s emission reduction targets and adaptation needs span a long-time horizon and will require significant public and private funding. A strategic approach to funding and financing the climate transition is needed, which can respond to the long-term and dynamic nature of climate change.
- 7 This paper proposes a funding and financing work programme that will have its first report back in October 2021. It will build upon decisions in Budget 2021 and earlier to ensure our long term emissions targets and adaptation needs can be met. It will focus in particular on fiscal management and budgeting tools and processes, as well as the preferred institutional arrangements needed to unlock private capital to meet climate goals, and how to consider the impact of all public investment on climate policy goals.
- 8 The work programme will be led by the Treasury working closely with the Ministry for the Environment (MfE). The Minister of Finance and Minister of Climate Change will provide regular updates to Climate Ministers through the Climate Ministers Response Group.
- 9 This paper focuses on the immediate work programme to support the ERP and all climate aligned Budget 2022 decisions. It also sets out the basis for an ongoing work programme beyond that to further support the National Adaptation Plan.

## **Background**

### *Climate change policy context*

- 10 New Zealand’s economy requires significant change to meet New Zealand’s emission reduction targets and adaptation needs. This transition will necessitate significant investment from public funds and the private sector.
- 11 The pathway to a low-emissions, resilient economy is uncertain. The magnitude and distribution of the direct costs and benefits of the transition will depend on domestic policy choices, the actions of other nations, technology developments and a range of other factors. The government will have to make decisions, including on funding and financing, despite the high level of uncertainty in order to meet emission reduction targets and to address

adaptation needs in a timely manner. These decisions may also have co-benefits in areas such as health, productivity and biodiversity.

- 12 A wide range of policy areas will be impacted by the transition across a long time period. In the near term, there are several upcoming milestones that are likely to have significant funding and financing implications. These include:
  - 12.1 Decisions which will be taken by 31 December 2021 on emissions budgets 2022-25, 2026-30 and 2031-35 and an Emissions Reduction Plan (ERP) to achieve those budgets.
  - 12.2 Decisions which will be taken on New Zealand's Nationally Determined Contribution to the Paris Agreement target for 2030 by October 2021.
  - 12.3 The National Adaptation Plan (NAP), an all-of-government plan to outline the actions New Zealand will take to address the risks identified in the first National Climate Change Risk Assessment. The Climate Change Response Act requires the NAP to be completed by August 2022.
  - 12.4 The Climate Adaptation Act (CAA), focussing on addressing the complex legal and technical issues associated with managed retreat, which government aims to introduce to the house in this parliamentary term
- 13 Given the breadth, scale and duration of the transition, a strategic, cross-government approach to funding and financing – including both public and private funds – is needed to support mitigation and adaptation objectives.

#### *Recent decisions and recommendations*

- 14 New Zealand has already taken a number of steps to support the financing of the transition, including policy initiatives which mobilise private investment. These include the establishment of New Zealand Green Investment Finance (NZ GIF) and the implementation of mandatory climate risk reporting in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD).
- 15 Through the Budget 2021 process we allocated funding to the following strategic climate funding and financing related initiatives:
  - 15.1 NZ GIF received \$200m in the 2021/22 financial year in addition to a further \$100m of funding provided in contingency for 2022/23.
  - 15.2 MfE and the Treasury received \$1m of funding in the 2021/22 financial year to progress work on the funding and financing strategy.
- 16 At Budget 2021 the Minister of Finance indicated that it is his intention that from Budget 2022 onwards, the government will recycle revenue generated by the New Zealand Emissions Trading Scheme (ETS) to emissions reductions and related work. How to do this, including through hypothecation

and use of ETS proceeds will be specifically considered through the proposed work programme.

- 17 In his Budget 2021 speech, the Minister of Finance also noted that the current way in which Budgets are required to be produced makes it difficult to make the sustained and long-term investments needed to fix an intergenerational, multi-faceted, complex problem such as climate change.
- 18 In its draft advice to the Government, He Pou a Rangī, the Climate Change Commission (CCC) recommended a range of actions that involve decisions on climate funding and financing. Those most directly relevant to the proposed work programme include:
  - 18.1 “Developing and implementing a plan for recycling proceeds from NZ ETS unit auctions into emissions reductions, adaptation, climate education, equitable transitions and meeting international climate change obligations. This plan should include mechanisms to ensure that it contributes to equitable outcomes for Iwi/Māori” (recommendation 11.4a)
  - 18.2 “Starting to factor shadow emissions prices into policy and investment analysis in central government immediately” (recommendation 12.1)
  - 18.3 “Investigating and developing actions government can take to help mobilise private sector finance, including ways to improve access to low-emissions finance for Māori-collectives” (recommendation 13.2a)
  - 18.4 “Clearly communicate [the Government’s] strategy for purchasing offshore mitigation to meet the NDC and how it will identify and manage fiscal and other risks and their consequences” (recommendation 31.2)
- 19 This work programme will explore options to respond to those recommendations; initial decisions may be reflected in the ERP.

## **Analysis**

### *Objectives*

- 20 To support the overarching goal of ensuring a successful and just transition to a low emissions and resilient economy, work on funding and financing should meet the following objectives:
  - 20.1 Adequacy of funding – funding is provided from the public and private sectors, at the speed and scale needed to meet the challenge of the climate transition
  - 20.2 Certainty – there is certainty about Government’s direct investment in mitigation and adaptation over the long term.
  - 20.3 Durability – the systems and processes set up to fund climate change action are durable over long time periods, are fiscally sustainable, and

are able to respond flexibly to the dynamic nature of climate change and innovation

- 20.4 Private capital mobilisation – private capital is effectively deployed to meet climate objectives
  - 20.5 Alignment – the ability to track and align public funding with positive climate and resilience outcomes are increased over time
- 21 In addition to these core objectives, work should be guided by the following considerations:
- 21.1 The interaction of funding and financing proposals with fiscal sustainability (for example, considering the impacts on fiscal flexibility of setting aside funding) and ongoing work to modernise the public finance system
  - 21.2 The potential distributional impacts of the transition, including intergenerational equity issues
  - 21.3 The Crown’s obligations under Te Tiriti o Waitangi; the importance of designing in partnership with iwi/ Māori and the need to anchor in te ao Māori.
- 22 This work programme does not draw a distinction between adaptation and mitigation funding issues at this stage. However, the deployment of funding for each objective has different complexities and considerations which will be considered further as the work progresses.

*Government’s role in mobilising public and private finance*

- 23 A successful transition will require changes across the economy:
- 23.1 Some will be driven by government decisions on regulation and through the drivers of the ETS. The costs of regulation and the ETS will largely be met by the private sector.
  - 23.2 Some changes will require more direct government investment, including in areas where price signals and market forces on their own will be insufficient to meet climate targets.
  - 23.3 Government may also incur costs in purchasing international carbon units to help meet its domestic and international emissions targets
  - 23.4 The flow of private finance will need to be aligned with climate objectives
- 24 Government therefore has a wide range of roles in ensuring the transition to a low emissions and resilient economy is appropriately funded.

- 25 There are a number of interrelated policy considerations related to the government's role in directing public finance towards climate policy areas, including:
  - 25.1 Fiscal management tools - long term decisions on the scale of climate change funding
  - 25.2 Budgeting tools and processes - medium term changes to how regular budget decisions are made so climate considerations are embedded in decision making;
  - 25.3 Measures to understand the volume of public investment in climate action and how public expenditure contributes to climate outcomes;
  - 25.4 Institutional structures, in particular the appropriate role of a financial institution to drive public (and private) investment in adaptation and mitigation projects
  - 25.5 The role of government's own investment and procurement
- 26 Given the scale of investment required across the economy, it is also critical to mobilise private finance towards climate goals. Government can facilitate the mobilisation of private finance in a range of ways:
  - 26.1 Effective, clear and timely signalling of long-term climate policy decisions (for example through the NAP and ERP) underpinned by stable and enduring policy settings to provide investment certainty
  - 26.2 Setting price signals through the tax system (for example via effective emissions pricing) and regulatory pricing
  - 26.3 Supporting consumer and investor behaviour change and improving awareness amongst investors and consumers
  - 26.4 Financial system regulation, such as requirements on disclosure
  - 26.5 Market shaping and creation to drive investment that supports innovation
  - 26.6 Institutional structures, in particular the appropriate role of a financial institution to provide financial and other support such as advisory services to unlock further private investment
- 27 Of these areas we consider the most urgent areas for further work are the following, which represent the three immediate strands of the funding and financing workstream, and which will contribute towards the objective of accelerating climate investment:
  - 27.1 Explore fiscal management tools
  - 27.2 Explore budgeting tools and processes

27.3 Institutional issues, particularly the establishment or designation of an institution that aims to support public spending and mobilise private sector finance.

28 Further details on these workstreams are given below.

*Fiscal management tools and budgeting tools and processes*

29 This workstream will produce recommendations on how best to ensure the public finance system delivers the scale and certainty of investment needed to support the transition. This will include exploring:

29.1 Decisions that could be taken to ensure certainty of climate change funding over the long term, including linking expenditure to revenue sources such as the ETS or another metric such as a proportion of allowances of total public expenditure<sup>1</sup>

29.2 The establishment of a particular fund or allowance

29.3 The suitability of existing Vote and Appropriation structures

29.4 Strengthening measures to track public expenditure on climate change, including through the <sup>[33]</sup> shadow carbon pricing in Cost Benefit Analysis, <sup>[33]</sup>

30 When considering high level structures linking climate revenue and expenditure (such as hypothecation) we will need to look at:

30.1 The revenue source, including the different revenue streams within the ETS

30.2 The certainty of this revenue; the price and volume of New Zealand Units in the ETS may vary significantly

30.3 How the revenue should be used, including options such as:

30.3.1 <sup>[33]</sup>

30.3.2

30.3.3

30.3.4

30.4 How to define and track climate-aligned spending

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<sup>1</sup> For example, the European Commission has set a target that at least 30% of its multi-annual budget and Covid recovery fund will be spent on achieving the EU's climate neutrality goal by 2050

- 30.5 The strength and flexibility of the link between revenue and expenditure, given there will not be an exact match between revenue and the amount government should spend on climate objectives.
- 31 Some stylised options for how the recycling of ETS proceeds could be recycled are set out in Annex 1.
- 32 This workstream will need to consider the interaction with ongoing work to modernise the public finance system. Budget 2022 will pilot a new “cluster” approach to Budgets in two clusters, one of which is a “Natural Resources” cluster. This cluster will set priorities, in keeping with all-of-Government priorities, including how the three agencies in the Natural Resources cluster contribute to achieving our climate change objectives. However, as will be the case with other cross-cutting issues where policies sit across multiple departments, work will need to be done to develop a climate change focussed Budget package. Options will be considered by the Treasury as it works through the interaction of the cluster process and the Budget 2022 strategy.
- 33 This workstream will also seek decisions how to manage and monitor progress towards New Zealand’s emissions reduction targets, including the fiscal risk from our Nationally Determined Contributions (NDCs) under the Paris Agreement; an obligation which is not currently reported under generally accepted accounting practice. Preferred option(s) will be included in the public consultation materials of the Emissions Reduction Plan in August 2021, and we will seek a decision on how to report on this obligation alongside the package of NDC decisions, by October 2021.
- 34 Work is underway on measures to track public expenditure on climate change. Cabinet invited the Minister of Climate Change to report back with proposals to ensure future government policy and investment decisions are resilient to future climate change impacts, and existing government investments, policies and regulatory systems are well-prepared to meet the potential challenges of future climate change impacts by June 2021 [CAB MIN-19-0509 refers].
- 34.1 Climate change was included for consideration in the Capital Panel for Budget 2021. Agencies were asked to consider how their investment proposals addressed mitigation and adaptation/resilience. The Treasury intends to report lessons learned to the agencies involved in the Capital Panel and those lessons will be incorporated into the process for Budget 2022. Progress on this will be incorporated into the proposed October report back within this work programme.
- 34.2 Officials are developing non-statutory guidance for central government policymakers to consider climate resilience in policy decisions. The guidance will provide a step by step screening and assessment process to determine how the policy may impact or be impacted by our exposure, vulnerability and adaptive capacity to climate change. [231]

- 35 Cabinet also agreed that Climate Implications of Policy Assessment (CIPA) disclosures include information on the value of emissions reductions, using the same shadow emissions pricing values that will be incorporated into guidance for Budget 2021 and cost-benefit analyses [CBC-20-MIN-0126 refers]. Progress on this will be incorporated into the proposed October report back within this work programme.

*Institutional settings*

- 36 [33]

[33]

## Implementation

- 42 Though this work programme would be led by Treasury, we have asked officials to develop a governance arrangement covering both the Treasury and the MfE. This will ensure this funding and financing workstream aligns with other climate change policy programmes.
- 43 Treasury and the MfE will engage in targeted consultation with organisations including (but not limited to):
  - 43.1 The Ministry of Business Innovation and Employment
  - 43.2 New Zealand Green Investment Finance Ltd
  - 43.3 Energy Efficiency & Conservation Authority
  - 43.4 Guardians of New Zealand Superannuation
  - 43.5 Accident Compensation Corporation
  - 43.6 Māori/iwi investors
  - 43.7 [33]

## 43.8 [33]

- 44 These work streams will progress in parallel with the development of the ERP and NAP, which must both be underpinned by a credible strategy on funding and financing.
- 45 The government intends to publicly consult on emissions budgets, the draft ERP, and the NDC in mid-August and September. Decisions will be taken by Cabinet on the ERP and NDC in October, with announcements and publications by 31 December 2021. Therefore, we intend to include commentary on ETS proceeds recycling, Cabinet decisions on how to manage and monitor progress towards New Zealand's emissions reduction targets, including on the fiscal risks from New Zealand's NDCs, and highlight the institutional settings workstream as a priority for action in those public consultation documents. The final version of the ERP and emissions budgets published before the end of 2021 will contain more detail on funding and financing.
- 46 The government intends to publicly consult on the NAP in February 2022, and to publish the final Plan by August 2022. We intend to include commentary on the progress made in the institutional settings workstream with relation to adaptation, and highlight key questions around managed retreat as priorities for action as part of the public consultation documents of the NAP.
- 47 We propose to provide an update to the Climate Ministers Response Group (CMRG) during this work programme to help coordinate it with the wider climate policy decisions listed above.
- 48 We propose to report back to Cabinet in October 2021 at the latest with recommendations covering the workstreams set out above. We will look to identify where decisions on some workstreams can be sought through earlier report backs to ensure this work progresses at pace. This will support the development of bids for Budget 2022. Any legislative work, for example related to new or existing financial institutions, would follow in 2022.
- 49 [33]

### **Financial Implications**

- 50 There are no immediate financial implications of the proposal in this Cabinet paper, noting Budget 2021 decisions have provided funding for the initial policy work [CAB-21-MIN-0116.11 and CAB-21-MIN-0116.12 refer]. However, we anticipate potentially significant financial implications as this work progresses.
- 51 There may be some elements of the ERP for which a fast-start ahead of Budget 2022 would make a material difference to the delivery of emission reductions in the first budget period (2022-25). Funding for implementation-ready action in the Emissions Reduction Plan could be considered later in

2021, once ERP decisions have been taken and a better picture is available of investment opportunities and their implementation readiness. Any decisions on out of cycle funding will need to consider the trade-offs between fiscal management and emissions reduction.

### **Legislative Implications**

- 52 There are no legislative implications to this proposal but the work may lead to recommendations with legislative impacts.

### **Impact Analysis**

#### **Climate Implications of Policy Assessment**

- 53 The CIPA team has been consulted and confirms that the CIPA requirements do not apply as there is no direct emissions impact at this stage. While the programme seeks to ensure funding and financing for policies which will decrease greenhouse gas emissions and increase climate resilience as key policy objectives, the strategy does not directly have any emissions impact at this stage.
- 54 The CIPA team will work with officials developing the proposals to assess the emissions impacts of policy proposals as they are advanced – as appropriate – at a later date.

#### **Population Implications**

- 55 There are no meaningful population implications expected at this stage.

## **Te Tiriti o Waitangi Implications**

- 56 The proposals in this paper do not have any immediate implications under Te Tiriti o Waitangi. However, Māori have a significant stake in climate change action, and have Treaty-based rights and interests in natural resource use and management. It will be critical when implementing final proposals to uphold Treaty of Waitangi principles.
- 57 To date officials have focussed on scoping the required work and have not yet engaged on the work programme with iwi/Māori. Recognising the importance of climate change action on Māori, officials will prioritise genuine engagement with iwi/Māori in the next stage of the work programme, with initial engagement sessions in July 2021.
- 58 We acknowledge that in seeking initial decisions by October 2021 there will be reduced opportunity for engagement. However, as noted above, ongoing work will be needed on funding and financing the climate transition beyond October 2021. Officials will seek to establish relationships and identify opportunities to work together on this kaupapa in the longer term.

## **Human Rights**

- 59 The proposals in this paper are not in any way inconsistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

## **Consultation**

- 60 The following government departments and agencies have been consulted on this Cabinet paper:
- 60.1 The Department of the Prime Minister and Cabinet
  - 60.2 The Ministry of Business, Innovation and Employment
- 61 The Green Party was consulted as this relates to the Cooperation Agreement.

## **Communications**

- 62 There will be no proactive communications of this proposal. Communications will be developed in line with any decisions made as part of the October 2021 report back.

## **Proactive Release**

- 63 This paper will be proactively released within 30 business days of decisions being confirmed by Cabinet, with redactions as appropriate under the Official Information Act 1982.

## Recommendations

The Minister of Finance and Minister for Climate Change recommend that the Committee:

- 1 **note** that in December 2020, Cabinet invited a report back on a strategic framework for funding and financing the climate transition, including the role of proceeds from emissions unit auctions [CBC-20-MIN-0126];
- 2 **note** that there are significant investments arising in the near future from the Emissions Reduction Plan, National Adaptation Plan, and associated climate policies;
- 3 **note** that New Zealand's approach to economic and fiscal management must support its emissions reduction targets and adaptation needs;
- 4 **note** that a strategic approach is needed to deliver the necessary speed and scale of funding for the transition, including through mobilising private capital;
- 5 **agree** that the Treasury undertakes a new work programme on funding and financing Aotearoa's just transition to a low emissions, resilient economy, with the Ministry for the Environment's support;
- 6 **note** the inter-related objectives of this work:
  - 6.1 Adequacy of funding – funding is provided, from the public and private sectors, at the speed and scale needed to meet the challenge of the climate transition
  - 6.2 Certainty – there is certainty about Government's direct investment in mitigation and adaptation over the long term
  - 6.3 Durability – the systems and processes set up to fund climate change action are durable over long time periods, are fiscally sustainable, and are able to respond flexibly to the dynamic nature of climate change and innovation
  - 6.4 Private capital mobilisation – private capital is effectively deployed to meet climate objectives
  - 6.5 Alignment – the ability to track and align public funding with positive climate and resilience outcomes are increased over time.
- 7 **note** the key issues that will need to be addressed as part of the work programme, including:
  - 7.1 Identifying methods to ensure clarity of public finance for adaptation and mitigation activities, including:
    - 7.1.1 fiscal management tools (such as making commitments to the source and scale of climate related funding)

- 7.1.2 budgeting mechanisms (such as decision making processes and structure of Votes)
  - 7.1.3 assessment and monitoring tools (such as shadow carbon pricing and climate impact assessments) to support the alignment of public spending decisions and climate policy objectives.
  - 7.2 Developing a preferred institutional arrangement to accelerate the mobilisation of private capital to fund adaptation and mitigation projects.
- 8 **Agree** that Treasury and Ministry for the Environment can undertake consultation with external stakeholders and investors as part of the development of the strategy, including:
- 8.1 Ministry for Business Innovation and Employment
  - 8.2 New Zealand Green Investment Finance
  - 8.3 Energy Efficiency & Conservation Authority
  - 8.4 Guardians of New Zealand Superannuation
  - 8.5 Accident Compensation Corporation
  - 8.6 Maori/Iwi investors
  - 8.7 [33]
  - 8.8
- 9 **invite** Ministers to provide options and seek decisions on an initial approach to funding and financing by October 2021 at the latest, including on:
- 9.1 A method for and use of recycling Emissions Trading Scheme proceeds
  - 9.2 An approach to climate change funding through Budget 2022 that is aligned with the direction of the public finance system modernisation work programme
  - 9.3 Tools for monitoring public expenditure on climate action, including ensuring future government policy and investment decisions are resilient to future climate change impacts, and an approach to associate a dollar value with emissions and emission reductions over time, [33]
  - 9.4 Monitoring progress towards New Zealand's emissions reduction targets, including the fiscal risk of our Nationally Determined Contributions (NDCs) alongside decisions on updating the NDC

- 9.5 Options on the appropriate institutional landscape to support disbursement of public funds and accelerate the mobilisation of private sector finance;
- 10 **note** that we will consider opportunities for earlier report backs and decisions on key parts of these workstreams where possible;
- 11 **note** that the Emissions Reduction Plan will include a chapter on funding and finance, which will reflect progress or decisions made within this work programme;
- 12 **note** that decisions made as part of the October 2021 report back will inform Budget 2022 bids and decisions;
- 13 **note** that a fuller work programme will be required beyond October 2021 and invite Ministers to report back with the next areas of work by May 2022.

Authorised for lodgement

Hon Grant Robertson

Minister of Finance

Hon James Shaw

Minister of Climate Change

[33]