The Treasury

Budget 2024 Information Release

September 2024

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[31] 9(2)(f)(ii) - to maintain the current constitutional conventions protecting collective and individual ministerial responsibility

[33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

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[36] 9(2)(h) - to maintain legal professional privilege

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[38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice

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TE TAI ŌHANGA
THE TREASURY

Treasury Report: Advice on the future of the Climate Emergency Response Fund

Date:	1 March 2024	**Report No:**	T2024/415
		File Number:	SH-10-8

Action sought

	Action sought	Deadline
Hon Nicola Willis **Minister of Finance**	**Agree** to disestablish the Climate Emergency Response Fund mechanism.	8 March 2024

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
Anastasia Kosteckyj	Analyst, Climate Change	[39]	[35]	✓
Nicky Lynch	Manager, Climate Change			

Minister's Office actions (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report	

Enclosure: No

Executive Summary

You have indicated your preference to close the Climate Emergency Response Fund (CERF) mechanism. This report seeks your formal agreement to proceed with disestablishing the CERF.

The CERF was established to recycle Emissions Trading Scheme auction cash proceeds and to provide a mechanism to "crowd in" investment in medium- and longer-term climate objectives.

At the Mini Budget, the Government agreed to reallocate ETS proceeds towards achieving other objectives [CAB-23-MIN-0490 refers]. This has left the balance of the CERF at $0.

You have also indicated that you:

- intend to pursue an approach to climate change strategy that will place less reliance on public investment as a lever, and make greater use of market mechanisms, such as the Emissions Trading Scheme (ETS); and
- would like to accelerate closing down the CERF and associated monitoring arrangements.

In our view, the CERF as a mechanism is not well aligned to your strategy for achieving emissions reductions or your fiscal management goals. We suggest that Cabinet confirm the discontinuation of the CERF via Minister Watts' upcoming Cabinet paper on New Zealand's Climate Goals and Obligations, scheduled for 15 April.

We do not think that the disestablishment of the CERF as a funding mechanism poses a material risk to the Government's ability to meet its obligations under the Climate Change Response Act in relation to emissions budgets and targets, or your ability to manage climate related costs. The core reason for this is that there remain a range of tools and actions available to the Government to manage the costs of climate change, including considering core policy settings, maintaining fiscal headroom, use of the operating and capital allowances, reprioritisation, and bespoke tools if required.

In the short-term, we think that funding climate policy through operating and multi-year capital allowances - and through reprioritisation of agency baselines - should be sufficient. However, you may wish to consider other tools to help you manage the expected future costs associated with climate change – including from physical impacts and the transition to lower emissions – over the long-term.

Recommended Action

We recommend that you:

a **agree** to notify Cabinet that you wish to disestablish the Climate Emergency Response Fund (CERF) mechanism

Agree / Disagree

b **agree** that officials include a recommendation to discontinue the CERF in the planned New Zealand's Climate Goals and Obligations Cabinet paper

Agree / Disagree

c **note** that officials will continue to investigate opportunities for savings, including from initiatives previously funded through the CERF, where funding is low value and/or is not aligned with your priorities

d **note** that we can immediately cease all monitoring and reporting on CERF funded initiatives, but this risks criticism from the Auditor-General for lack of transparency and accountability

e **note** that the risk in recommendation [d] can be mitigated if we carry out a final closing CERF data collection and reporting exercise

f **agree** to either option [i] or [ii]:

i. [Treasury recommended] hold a final data collection and reporting of CERF financial and performance data at the end of the 2023/24 financial year

Agree / Disagree

OR

ii. immediately cease all monitoring and reporting of initiatives previously funded from the CERF

Agree / Disagree

g **agree**, subject to recommendation [f], to include a recommendation to cease monitoring and reporting requirements for the CERF in the upcoming Cabinet paper on New Zealand's Climate Goals and Obligations

Agree / Disagree

h **note** that officials will continue to provide advice on how the costs associated with climate change can be managed through ongoing advice.

Nicky Lynch
Manager, Climate Change

_____/_____/_______

Hon Nicola Willis
Minister of Finance

_____/_____/_______

Purpose of Report

1. This report provides you with advice on formally discontinuing the Climate Emergency Response Fund (CERF) mechanism.

2. It also provides additional context on our current understanding of the expected fiscal impacts associated with climate change and the range of options available to the Government to manage these.

Background

3. At the Mini Budget, Cabinet agreed to reallocate available funding remaining in the CERF to Budget 2024 allowances [CAB-23-MIN-0490 refers]. This decision left the balance of the CERF at $0. Treasury indicated that, given legal obligations in this area, we would provide further advice to support a formal decision on whether the CERF should be disestablished.

4. You have also received advice on your fiscal strategy, which notes that climate change is one of several medium-term fiscal pressures that may be difficult to manage given the current fiscal outlook [T2023/1992 refers]. This report also provides you with our best current information on the expected magnitude and sources of fiscal costs associated with climate change, and options in the short-term to manage these costs.

Future of the Climate Emergency Response Fund

5. The CERF was established in 2021 [CAB-21-MIN-0349 refers]. The rationale for its establishment was to create a mechanism to recycle proceeds generated from the Emissions Trading Scheme (ETS) for climate purposes. The design of the CERF was intended to do this in a way that would:

   - enable "crowding in" of high value public climate investments that might otherwise be crowded out by the short-term nature of the Budget process
   - build social licence for potentially rising carbon prices; and
   - support the funding needs associated with the release of the first Emissions Reduction Plan (ERP1) and reduce emissions.

CERF allocations and spending to date

6. The CERF funding structure is similar to the multi-year capital allowance, with spending allocated over a four-year forecast. Table 1 reflects original allocations through the CERF at the relevant Budgets over the respective forecast periods.

Table 1: Gross allocations through the CERF at Budget 2022 and 2023 ($m) over the respective Budget forecast periods

	Operating						Capital	Total
	21/22	22/23	23/24	24/25	25/26	26/27	Total ($ms)	Total ($ms)
Budget 2022 Pre-commitments	-	228.8	268.8	262.5	105.0	-	-	865.1
Budget 2022	47.4	396.5	783.0	734.7	788.6	444.4	198.5	3,393.1
Budget 2023	-	241.0	255.6	387.4	379.8	308.6	300.0	1,872.4
Total	47.4	866.3	1,307.4	1384.6	1273.4	753.0	498.5	6,130.6

Note: This table does not reflect transfers and savings that have since been realised from initiatives funded through the CERF. Blue cells denote the relevant forecast period.

7. $865 million of pre-commitments were made before Budget 20222 ($840 million for international climate finance commitments and $35 million for the Government Investment in Decarbonising Industry programme). At Budget 2022, the CERF supported a $2.9 billion package over the 2022/23-2025/26 period. At Budget 2023, $1.9 billion was allocated through the CERF over the 2023/24-2026/27 period.

8. Since Budget 2023, some funding allocated through the CERF has been returned through savings processes, including the Rapid Savings Exercise ($261 million) and Mini Budget ($1.4 billion).

9. Our current estimate is that there is around $4 billion allocated to CERF initiatives over the forecast period from 2023/24 to 2026/27. We are doing further work to refine our estimates to support investigation of possible further savings as part of the Budget 2024 savings exercise. We discuss the indicative savings submitted by agencies below in paragraph 23.

Alignment with your fiscal and climate strategies

10. In our view, disestablishing the CERF as a mechanism is consistent with your fiscal and climate strategies. We understand that the Government intends to pursue an approach to its climate change strategy that will place less reliance on public investment as a lever, and makes greater use of market mechanisms, such as the ETS.

11. We have considered whether disestablishing the CERF could pose a material risk to the achievement of New Zealand's wider climate change targets and goals, such as:

    - meeting our first Nationally Determined Contribution (NDC1) under the Paris Agreement
    - managing the potential costs of climate adaptation.

12. While we expect the future costs associated with climate change will be considerable (including the costs to achieve future emissions budgets), we do not think disestablishing the CERF poses a material risk to your ability to manage these costs. This is because other levers and tools remain available to the Government to manage these costs and fund high value climate initiatives, should public investment be required.

    - In the short-term, the Government can continue to fund potential high value climate policies through operating and multi-year capital allowances, and through reprioritisation of agency baselines.

- In the longer term, there are a range of other actions the Government can take to manage costs down and support sensible investments, that may be better aligned with your fiscal and climate strategies. Some key actions are outlined in the final section of the report.

[36]

18. There are a range of actions from the first ERP that Ministers have signalled they do not wish to proceed with. The Climate Change Chief Executives Board secretariat is preparing a Cabinet paper for consideration in April to confirm that these actions will be halted and provide overall advice on the risks in aggregate to the sufficiency and currency of the current ERP.

19. We have included the original action in the ERP related to the CERF (which was to establish the CERF) in this process. The IEB secretariat's advice at this time is that the

changes the government is actioning to date are not expected to have a material impact on our ability to achieve the first emissions budget.

20. The paper also proposes that delivery of ERP2 be the main strategy for responding to the risk that ERP1 could become increasingly less current. [36]

21. [36]

Next steps and related decisions

22. **Disestablishing the CERF:** A Cabinet decision is required to formally disestablish the CERF. We suggest including a recommendation in an upcoming Cabinet paper on New Zealand's Climate Goals and Obligations. We will provide proposed text to the CCIEB Secretariat, which is preparing this paper.

23. **Potential for further savings from initiatives previously funded through the CERF:** As part of Budget 2024 Guidance, agencies were advised initiatives funded from the CERF in previous Budgets were eligible savings options. Initial agency returns have identified $651.1 million of savings from initiatives previously funded at least partially through the CERF.

    - We are currently investigating how these savings compare to original allocations and CERF monitoring and reporting data. We will use this to support ongoing discussions with agencies about their savings proposals as part of the Budget 2024 process and advise you further on the potential for additional savings.

24. **Monitoring and reporting on the CERF.** You have indicated that you would like to stop all monitoring and reporting on the CERF [T2024/249 refers].

25. The Office of the Auditor General has indicated that, given the high level of public interest they will be paying close attention to public sector organisation climate change related activity, including risk management, spending and reporting.

26. We think that there are two options as to when to formally close down CERF monitoring and reporting.

    - Closing CERF reporting immediately and conveying this decision to agencies. This option will limit any further use of officials' time in collecting and reporting CERF data. However, it will create gaps in reporting between now and the point in time at which new arrangements better aligned with your priorities are established. Partial monitoring and reporting data limits transparency on what has been spent over the course of the CERF and what outcomes have been achieved. There is a risk of public criticism if all reporting is abruptly stopped.

    - Running a limited final data collection of CERF expenditure and performance data at the end of the financial year. This option would improve transparency of government expenditure and provide valuable evaluation data.

27. On balance, we recommend running a final round of CERF reporting, since it more effectively mitigates the risk of public criticism.

28. With the Fund no longer operating, there are other mechanisms that can be used to support reporting on public sector expenditure to support emissions reduction and adaptation. The Treasury is providing advice on how to improve reporting across the

system, and reporting on climate change related spending should be considered as an element of that system [T2023/335].

Managing the expected fiscal costs of climate change

29. The section below summarises our current understanding of some of the potential future fiscal implications of climate change, and the range of options available to Governments to manage these costs.

The future costs of climate change are only partially known. However, it is likely they will be large and wide-ranging.

30. Climate change is already creating and exacerbating pressures across the economy, including:

    - increased acute costs from extreme weather events like floods or droughts;
    - economic adjustment costs from chronic long run environmental changes, such as water availability for agriculture, and impacts on fisheries and tourism
    - the transition to low-emissions is expected to affect different sectors differently, potentially creating disruptions, shrinking industries, and impacting consumer prices.

31. These impacts will create fiscal pressures in multiple areas, at different times. The Treasury's report, Ngā Kōrero Āhuarangi Me Te Ōhanga: Climate Economic and Fiscal Assessment 2023, summarises the range of potential impacts to the expenditure and revenue the government could experience due to climate change.

The Government's fiscal position has been resilient to natural hazard shocks, but future costs will be harder to manage in the context of other challenges to the public finances

32. The physical impacts of climate change present a unique challenge to our fiscal position, due to the combination of risks that slowly develop over time (e.g. sea-level rise) alongside other more acute risks (e.g. one-off significant weather events).

33. In the past, low debt and operating surpluses have provided buffers that have allowed the Government to contribute to the response and recovery from acute climate-related events, such as extreme storms or floods. However, future costs are expected to rise due to more severe and frequent natural hazards. Depending on future policy decisions, increased costs associated with increased use of retreat or investment necessary to enable communities to remain in their current location (where that is cost-effective), and possible changes to the insurance market are also anticipated. Some aspects of these costs may fall to central government.

34. Chronic changes will add to these costs (expenditure or revenue impacts), making the fiscal impacts more difficult to manage, particularly given the fiscal outlook and other fiscal pressures (e.g. demographic change) over the medium-term.

We expect calls on central government to fund or finance climate-related costs will increase in future

35. Spending to date by central government to manage the costs associated with emissions reduction have been relatively small compared to what we expect total future climate-related costs might be.

36. Table 2 outlines some of the potential future costs associated with both physical climate impacts (including potential adaptation responses) and the transition to lower emissions over the medium-term.

Table 2**: **Select areas of expected cost to Government from climate change over the short- to medium-term.

Source	Description and costs
Response and recovery from climate-related events such as floods and droughts (i.e. post-event costs)	Fiscal costs are expected to increase but are difficult to estimate because they depend on the scale of future climate impacts and adaptation measures taken. However, the response and recovery from the North Island Weather Events resulted in about $4.7 billion being allocated (November 2023), providing an illustration of the potential cost of severe weather events.[1]
Government funding of measures to support adaptation to climate change (i.e. to prevent costs)	Future fiscal costs of adaptation are expected to increase but are difficult to estimate. These costs are hard to isolate because they sit withing wider Crown activity, such as managing national infrastructure, providing information, and setting legislative frameworks (e.g., resource management law). While councils are responsible for local natural hazard management, we expect calls for central government contributions to local public goods to increase.
Government funding of measures to support domestic emissions reduction	Treasury conducted some illustrative estimates based off this modelling as part Ngā Kōrero Āhuarangi Me Te Ōhanga: Climate Economic and Fiscal Assessment 2023. Assuming the Crown directly contributed 10% to 30% of these costs, this could mean additional fiscal costs of between $3.8-$11.5 billion through to 2050 above levels assumed by the Climate Change Commission.
Purchasing the offshore emissions reductions needed to meet international commitments	Meeting our first Nationally Determined Contribution (NDC1) under the Paris Agreement represents a significant fiscal risk. Indicatively, Treasury scenarios for these costs range between $3.3-23.7 billion to purchase the offshore mitigation required to meet NDC1.[2]

37. In our view, the potential extent of future costs makes it more important that the government require a strong case for public investment (where it chooses to do so) and avoid low value spending in the short-term. However, we recommend you remain open to investments that could reduce future costs, for example such as reasonable marginal additional costs for infrastructure projects to make them more resilient to climate risks.

There are a range of ways to manage the expected costs from climate change

38. While significant costs are likely to be unavoidable, particularly from future weather events, choices the government makes can have a bearing on the extent of the costs and who meets them. We would suggest that an overall approach to managing the costs associated with climate change should make use of all available levers:

- **Manage down the costs through policy choices.** In both adaptation and mitigation, policy choices have the potential to either incentivise efficient use of resources and management of risks, reducing overall costs, or cause them to rise significantly.
- **Be clear on the role of government.** For example, being clear that the role of the government is not to bear all costs associated with managed retreat, but to share risk and costs with homeowners, businesses and councils. The Treasury will provide you with further advice on adaptation priorities ahead of the planned Climate Priorities Ministerial Meeting provisionally scheduled for March.

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[1] While we are not able to attribute specific events to climate change, climate change is expected to exacerbate the frequency and severity of severe weather events.

[2] Ngā Kōrero Āhuarangi Me Te Ōhanga: Climate Economic and Fiscal Assessment 2023

- **Maintain fiscal headroom**: Returning OBEGAL to surplus as soon as practicable and maintaining surpluses over time will help to ensure there remains fiscal space to manage costs from climate impacts over time. When deciding on your fiscal strategy, including your long-term objectives for net debt and OBEGAL [TR2024/312 refers], you should consider the long-term risks from climate change. It will also be important to better integrate information on the scale and nature of climate change costs – including as updated information comes to light – into medium-term fiscal sustainability advice.

- **Use, and consider ways to improve, existing fiscal management mechanisms:** Where there is strong case for public investment, leverage Budget allowances and reprioritize existing spending to support high value public investment.

- [33]