

## **Intensity-based regulation versus output-based free allocation: A clarification of comments to the Select Committee**

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This should be read as a supplement to the earlier note.

(See [http://www.motu.org.nz/files/docs/ETS\\_notes\\_for\\_Select\\_Committee\\_Suzi.pdf](http://www.motu.org.nz/files/docs/ETS_notes_for_Select_Committee_Suzi.pdf).)

Both intensity-based regulation and output-based free allocation are motivated by concerns about trade exposure and its implications: environmental leakage and economic regret that is not taken into account in firm decisions and could hence lead to unnecessarily adverse social effects on jobs and communities.

The 'output' used for free allocation or as the basis of 'emissions per unit of output' definition of 'intensity' would be the same.

Either form of protection would need to be carefully restricted to output from processes that are highly at risk. Both forms of protection are costly to the tax-payer. Many other companies that are at risk but are unprotected are among the tax-payers.

Protection should be offered on an equal basis to new entrants as to incumbents. Potential new entrants are likely to be more at risk though if they do not arrive they are not associated with losses of existing jobs.

Both would need to be designed to be phased out:

- As countries begin to be covered by Kyoto
- Over time – taxpayers should not be expected to provide ongoing subsidies to uncompetitive companies regardless of the cause of their non-competitiveness.

Output-based free allocation has the distinct advantage of being directly integrated in and consistent with the wider ETS. It also makes the total level of protection provided by taxpayers visible. This would make it the preferred instrument on an administrative basis.

Currently the total level of free allocation is capped. This could be maintained in the sense of a projection. The level of free allocation per unit output could be defined so that, given projected output, the cap will not be breached in each time period. Keeping the cap means that anticipation of new entrants will lower the assistance available to existing activity. The level of total assistance to any sector is a political decision – no economic modelling can give a precise answer on the appropriate level.

Output-based free allocation is the approach the Australians are broadly using for trade-exposed sectors. A short list of very high emissions, very high trade exposure processes could potentially be shared with the Australians. We would not need to provide exactly the same level of protection.

A report we wrote for the Climate Change Leadership Forum on trade exposure issues is at:

<http://www.climatechange.govt.nz/emissions-trading-scheme/input-and-engagement/climate-change-leadership-forum/2008-06/cluster-b-report.html>

### **Agricultural emissions**

The paper Andrew Sweet and I wrote on Agriculture emissions trading (and forestry) is at [http://www.motu.org.nz/publications/detail/inclusion\\_of\\_agriculture\\_and\\_forestry\\_in\\_an\\_emissions\\_trading\\_system\\_nz](http://www.motu.org.nz/publications/detail/inclusion_of_agriculture_and_forestry_in_an_emissions_trading_system_nz)

A recent presentation on this is also available on the Motu site [http://www.motu.org.nz/publications/detail/how\\_can\\_agriculture\\_be\\_included\\_in\\_an\\_emissions\\_trading\\_scheme](http://www.motu.org.nz/publications/detail/how_can_agriculture_be_included_in_an_emissions_trading_scheme). Other material has been prepared for MAF but has not been publicly released yet.