IETA Comments on Review of the New Zealand Emissions Trading Scheme

Submission to the New Zealand Ministry for the Environment

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Introduction

The International Emissions Trading Association (IETA) is a nonprofit business association with over 300-members that supports the use of carbon markets to address the climate crisis. Our active members in Aoteaora New Zealand include compliance entities, financial companies, and advisory firms. IETA's mission is to establish market-based trading systems for greenhouse gas (GHG) emissions that are environmentally robust, fair, open, efficient, accountable and consistent across boundaries, and that are aligned with the goals of the Paris Agreement and the IPCC.

As one of the oldest emissions trading systems (ETSs) in the world, the New Zealand ETS is an example to the rest of the Asia-Pacific region of how to use carbon pricing to cut emissions. Since its inception in 2008, emissions from the energy sector have fallen by almost 10% and waste by 20%, although industrial emissions have inched up. Reforms made to the NZ ETS in recent years have boosted its integrity, including the setting of a cap.

With the recent events Aoteaora New Zealand has experienced – including the Auckland anniversary floods, the devastation wrought by Cyclone Gabrielle along the East Coast and Hawkes Bay, and the destruction in Canterbury just last month after the region experienced a month's worth of rain in a day – it is ever more pressing to address the climate crisis. IETA believes the NZ ETS should be at the core of the country's response, and this process presents an opportunity for changes to make it fit for the challenge.

This response to the **consultation on the review of the New Zealand ETS** outlines IETA's position and our recommendations to the Government of New Zealand to strengthen the role of the ETS in Aotearoa New Zealand's low-carbon development.

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1. Cap-and-trade as a workhorse

IETA advocates for improvements to the NZ ETS to achieve an increasing share of Aotearoa New Zealand's required reductions to meet its climate targets, including its 2030 Nationally Determined Contribution (NDC) under the Paris Agreement and longer-term net-zero ambitions for the following reasons:

- Emissions trading is more effective at ensuring the achievement of ambitious climate targets than direct regulations (e.g., carbon taxes) or government subsidies.[1]
- A workhorse cap-and-trade programme would achieve reductions at dramatically lower costs compared to command-and-control policies or government subsidies.
- Emissions trading responds to the central objective of climate change policy of efficiently directing capital within markets towards low-to-zero carbon emissions investments – with the right settings in place.

IETA welcomes the reforms made to the NZ ETS in recent years, particularly the move to introduce NZU auctions and a de facto cap. The NZ ETS of today is more aligned with similar systems around the world, positioning it well for future linkages. We also welcome the government's commitment to reducing gross emissions, underpinning this consultation process, as well as its ongoing commitment to nature-based solutions as part of Aotearoa New Zealand's climate strategy. However, continuous and frequent reforms introduce uncertainty to the market and risks hindering investment and NZ ETS liquidity.

Nonetheless, IETA also agrees that there are changes which could be made to enable the NZ ETS to function better and carry more of the load in driving Aotearoa New Zealand's decarbonisation. All four of the options proposed carry risk, as acknowledged in the consultation document, and whichever is chosen will need to be carefully managed to ensure smooth implementation.

Of the four, however, a mix of options 1 and 2 (using the existing NZ ETS levers to strengthen incentives for removals and creating increased demand for removals including by allowing overseas buyers to purchase such units) are more aligned with IETA's principles.

2. IETA's principles

In addition to the aforementioned defined cap, scarcity of emissions allowances is also needed to create a clear price signal. The success of an ETS also requires long-term clarity and predictability of rules and targets – constant reforms undermine this. As well, key aspects of a well-designed and efficient market include:

- Transparency of design and operation
- Sufficient scale to operate and deliver emissions reductions
- No artificial barriers to access or participation
- Low transaction costs and limited bureaucracy
- Delivery without intervention (i.e., no price caps or price floors, no artificial supply barriers such as limits on the use of reduction units from projects)
- Adequate offset availability
- A fair and equitable allowance allocation process that does not withdraw capital from the firms and industries covered by the scheme, nor grants windfall profits

[1] See You-hua Chen, Chan Wang, Pu-yan Nie, Zi-rui Chen. *A clean innovation comparison between carbon tax and cap-and-trade system*, Energy Strategy Reviews, Volume 29, 2020, 100483, ISSN 2211-467X, https://doi.org/10.1016/j.esr.2020.100483.

- Recognition of the important link between the holder of allowances and the initiation of actions that create the reductions
- The need for trading systems to recognise all verifiable key abatement technologies, including carbon capture and storage (CCS)
- Well manged release of market data

3. The way forward for the NZ ETS

The recent adjustment to auction volumes and price setting, following a judicial review, is an example of how the NZ ETS's existing levers can be used to incentivise emission reductions; indeed prices jumped almost 30% the day after the announcement.[2]

IETA appreciates the government's concern that option 1 could lead to landowners planting more trees; however, we also believe it is for governments to decide on the role and place for removals under the NDC. Allowing overseas buyers access to removals NZUs, as proposed in option 2, could help absorb any increased supply that may result should the government pursue option 1. This would also help forge a link between the NZ ETS and other markets. Exposure to markets with a higher prevailing price may impact NZU prices, which in turn could lead to further reductions in gross emissions. However, there is unlikely to be such demand absent a corresponding adjustment to Aotearoa New Zealand's NDC for any exported units

A lot of investment has already been made in Aotearoa New Zealand's forests due to expected returns from the NZ ETS, based on NZU prices and expectations, and forward contracts signed for the units at an agreed price. Government intervention in this sector and inserting itself as the 'middleman', as proposed in option 4, risks spooking investors and driving away the capital that the land sector needs. Similarly, government interventions in the broader NZ ETS market – such as funding emissions-reduction projects at ETS-covered activities – also have an impact on the market and create distortions.

4. Conclusion

The reforms made in 2020 were welcome, and while agreeing that changes now to drive gross reductions are needed, IETA is concerned about continuous changes to the NZ ETS. There has been a rolling set of changes in recent years, and this creates uncertainty over the future of the policy and ultimately undermines the price signal the system is designed to send to drive investments. We hope that this review ensures the NZ ETS can be set on a course for the low-carbon future Aotearoa New Zealand has committed to and provide market certainty through limiting the necessity for further government interventions in the coming years.

IETA is grateful for this opportunity to comment on the review of the NZ ETS. We look forward to additional opportunities to provide comments. Any correspondence can be directed to IETA's Australia, New Zealand and Oceania Working Group Co-Ordinator, Katie Kouchakji (**kouchakji@ieta.org**).

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[2] See *NZ Market: NZU price rises 27% off the back of ETS price control change announcement*, Carbon Pulse, 26 July 2023. **https://carbon-pulse.com/213918/**