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ECO Submission on ETS Trading Scheme Review 2015/16: "Other issues" as defined by MfE

I. Introduction

Who we are

As noted in our February submission on the Priority issues, the Environment and Conservation Organisations of NZ (ECO) is the national alliance of 50 or so groups with a concern for the environment. ECO has been involved in issues of energy and land-use policy since its formation in 1971-2 and has been concerned at the greenhouse effect and have been active on climate change and related matters since the mid 1980s.

This submission has been prepared by members of the ECO Climate Change working group and the ECO Executive. Our policy positions were provided in the submission on Priority Issues in February 2016.

[redacted]

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The Review of the ETS

In this second set of submissions, ECO's submissions are in 12 point font and bold, the Ministry's text is in 11 point and unbolded except for headings.

ECO's Submissions : 4 "Other issues"

The Ministry States: *"Input from New Zealand Emissions Trading Scheme (NZ ETS) participants, other stakeholders and the public on the matters in this section will help determine the future direction of the NZ ETS. These matters include:*

- *business responses to the NZ ETS*
- *protecting competitiveness through free allocation*
- *managing unit supply, including issues related to forestry, international units and selling New Zealand Units (NZUs) by auction*
- *managing price stability*
- *operational and technical matters*
- *addressing barriers to the uptake of low emissions technologies.*

These issues need further analysis to identify potential solutions or approaches for consideration. On some issues, the review may need to consider developments connected with the new international climate change agreement. "

4.1 Business responses to the NZ ETS

As outlined in section two on the context and drivers for this review, the NZ ETS may not be encouraging businesses enough to plan for a more carbon-constrained future. Uncertainty about future carbon prices and about NZ ETS policy settings may also be contributing to this. There is currently limited information available to the Government on how businesses are making plans and decisions.

Many businesses and groups have interests across NZ ETS sectors, and are also affected by pass-through costs. For example, an iwi organisation may have to balance a forestry portfolio with other business interests, while still considering the impacts the NZ ETS will have on households and individual iwi members. These groups must make trade-offs between their different needs and the desired economic, environmental, social and cultural outcomes when planning.

Because of this, we are seeking views from a range of New Zealand businesses and sector interests, including iwi and Māori organisations. We are interested in your thoughts on how businesses incorporate the NZ ETS and carbon prices into their planning, and will use this information to inform the Government's thinking on the future direction for the NZ ETS.

Questions

3. *Do you consider the future cost of emissions in your business planning?* ***Yes/No***
   If yes, how do you do this?

ECO is not a business, but we observe a variety of responses by different businesses.

a) The plantation foresters have been wrong footed many times by policy instability and inept policy settings, so that their long term planning has been disrupted and confidence in the government to maintain carbon price signals has been lost.

b) We noted that foresters and many others used arbitrage between the imported hot air international unit price and the NZUnits to make a lot of money at the expense of the taxpayer and the climate.

c) Many companies have responded by investing in lobbying to influence climate policy and to shift costs to others rather than to invest in carbon reduction measures and technology.

4. What would improve your ability to take into account the future cost of emissions in your business planning?

a) Most companies will want certainty and security – the government should promise to avoid capricious policy changes, but it is probably not reasonable to promise fixed prices. Vested interest lobby-driven pressure to mute the price signal and / or quantity limits and to erode the policies to control emissions should be resisted, as should shifting of costs to others in the community.

4.2 Protecting competitiveness through free allocation

The Government allocates NZUs to particular activities to prevent NZ ETS costs from affecting international competitiveness, and to prevent the relocation of production to countries that do not have carbon pricing (this is sometimes called 'carbon leakage').

Comment 4.2 a) This policy is mis-conceived and has significantly distorted and delayed adequate business, investor and consumer responses, so leading to increasing long term distortion in production and consumption decisions. It has also encouraged investment in lobbying, and cost-shifting to taxpayers. Investment distortions and increasingly internationally uncompetitive decisions have resulted.

Comment 4.2.b) New Zealand has acted in bad faith in its use of international hot air units – and our reputation has been besmirched as a result.

The Government supports keeping the free allocation regime in place until at least 2020.

c) Maintaining free allocations perpetuates delays in people facing true price signals and is counter-productive to developing an economy that is carbon-efficient and constrained.

Carbon pricing is still not widely applied in economies that New Zealand competes with internationally, so some competitiveness risks may remain. However, a lack of clarity about the future of the free allocation regime may be a source of regulatory uncertainty.

d) Quite likely – NZ policy needs to send clear signals that are stable and credible.

As a result, we are interested in views on:

- *what future conditions would warrant reducing the rates of free allocation:*
- *when these circumstances are likely to arise.*

The free allocation of NZUs is designed to protect the competitiveness of firms engaged in activities that are both emissions intensive and trade exposed (EITE). These firms faced cost increases as a result of the introduction of the NZ ETS, but are unable to pass those costs on without risking their international competitiveness. Examples of highly EITE activities that qualify for free allocation include the production of lime, aluminium, iron and steel. Moderately EITE activities also receive an allocation, such as production of capsicums, cucumbers, protein meal and whey powder. Allocation rates are set to compensate firms for most, but not all, of their expected costs from the NZ ETS.[1]

Firms receiving a free allocation still face an incentive to reduce their emissions. They still have NZ ETS costs for a proportion of the emissions stemming from the EITE activities, and reducing their emissions may allow them to benefit from selling NZUs allocated to them.[2]

Allocation rates are tied to the one-for-two surrender obligation, so the number of units recipients receive would increase proportionately if this was removed or phased out. Free allocation each year amounts to around five million NZUs, which is relatively low compared to total annual unit surrenders (which are typically around 30 million) and to the amount of free allocation in some overseas emissions trading schemes[3]*.*

Questions

11 *Under what conditions should free allocation rates start to be reduced after 2020?*

a) These free allocations should be phased out now. The conditions for such phase out are:

I. They cloud investment horizons, send incorrect price signals, distort investment, production and consumption decisions.

II. They are effectively a subsidy to those who pollute and hence are in themselves anti-competititive and a burden on society and on our trading partners' goodwill.

III. The argument that other countries are as bad or worse simply leads to lack of mutual assurance and lack of action to reduce emissions.

12 What impact would it have on your investment decisions over the next few years if there was a clear pathway or criteria for phasing out of free allocation after 2020?

a) No doubt some companies will threaten to go overseas. Some may do so, but the continuing distortions of decision making under free allocation will leave New Zealand worse off, and the population poorer as a result.

1 Current allocation rates are 90 per cent for highly EITE activities and 60 per cent for moderately EITE activities.

2 The number of NZUs allocated is calculated on production rates, with recipients allocated a fixed number of NZUs based on average levels of emissions for an activity. If these firms reduce their emissions while maintaining production levels, they will have extra NZUs, which they can sell.

3 For example, as of 2013 around 60 per cent of units in the EU ETS were allocated, and the Korean ETS provides 100 per cent free allocation to all participants in its first implementation phase over 2015-2017.

4.3 Managing unit supply

We seek your views on how the supply of units into the NZ ETS should be managed up to and beyond 2020.

The NZ ETS was designed to be linked to international carbon markets, particularly to the Kyoto Protocol flexibility mechanisms. However, The NZ ETS stopped accepting international units from June 2015, transitioning it to a domestic-only scheme.

This means that new unit supply to the NZ ETS comes from two main sources:

- *NZUs transferred to forest owners for carbon removal activities*
- *the Government's annual free allocations for EITE industry activities.*

The quantity of NZUs provided each year through these sources is less than the amount participants need to meet emissions obligations each year.

4.3.a ECO NOTES:

Restriction on supply is an integral part of any "cap and trade" regime. Free allocation transfers wealth to those so subsidised, and any overallocation erodes the "cap". The point of a cap and trade system is to restrict quantity to allow the price to drive emissions reductions. If officials try to use policy and regulatory design to ensure there are ample emissions units to cover BAU emissions, the ETS will fail to deliver prices sufficient to incentivise economically efficient and fair emissions reductions.

As discussed earlier, there are a large number of NZUs banked in private accounts that can make up the shortfall, at least in the short term. These banked units will eventually deplete, particularly if the one-for-two surrender obligation is removed. This means that how the NZ ETS should be supplied with units in the medium-to-long term needs to be considered, including the relationship among potential sources of supply such as forestry, international units, and selling NZUs by auction.

4.3.b

Potential sources of supply should include:

i) Credits for carbon sequestration by native forest regeneration and recovery of other native ecosystems could be used as a course of NZUs. There would be good co-benefits in terms of biodiversity and ecosystem services gains.

ii) The banked units are in some cases sound, in other cases, where these are from, for example, Ukrainian hot air, they are unsound. It would be reasonable to require that units that were "hot air" units originally have a discounted exchange rate compared to genuine NZUs.

iii) The expectation of the holders of units about future prices for (and policies about) units, will govern when they choose to sell. The Ministry should be ensuring the integrity of the units supplied, restraining the supply, providing policy stability (but not the current status quo) and then allowing markets to function. Essentially a cap and trade system requires a cap, and policy and regulatory integrity, the price is determined by the players, noting our comments on a price floor (see answer 18 below).

iv) The supply of NZUs from emissions reductions, giving those who cut emissions or sequester carbon permanently, the ability to sell them, is integral to the ETS. The Ministry should not be finding other sources for the supply of NZUs to the market. In a perfect world, international units should be reliable, but we know these are not – and nor are the NZUs for which they were exchanged - and as long as there is no quality control on international units, New Zealand should not accept them, irrespective of the putative efficiency gains from free international trade in emissions units.

v) ECO supports that any new supply of units should be by auction, not by free allocation.

Forestry

Carbon removals from forestry are one of New Zealand's largest and most cost-effective domestic abatement options. The Government wants to identify any changes to the NZ ETS that could help increase the rate of forest planting.

Forestry is a significant industry in New Zealand, and an important part of the Māori economy. The NZ ETS is intended to encourage carbon removals through forestry by incentivising afforestation and re-planting, and discouraging deforestation. The forestry sector has played a key role in New Zealand meeting its past international obligations, and will continue to do so into the future.

Forests are classified differently under the NZ ETS depending on when they were first established. Owners of forests established after 1989 can voluntarily choose to participate in the NZ ETS and receive NZUs for the carbon removed by their trees. Owners of forests established prior to 1990, on the other hand, must participate in the NZ ETS and surrender emission units, but only if they deforest their land.[4]

The impact of the NZ ETS on the forestry sector has varied over time. Between 2008 and 2011, when NZU prices were higher (in the range of $15–$20), post-1989 forestry participation in the NZ ETS reached a high of around 60 per cent of the estimated area of eligible forest. Participation is currently lower, at about 45 per cent. This reduced participation rate is likely to be due to a fall in NZU prices, regulatory uncertainty and, until May 2014, a number of participants choosing to deregister from the NZ ETS using low cost international units.

Afforestation in New Zealand peaked in the 1990s, and then declined to 2008 due to perceptions of low forestry profitability, the cost of purchasing land, and returns from competing land uses. The introduction of the NZ ETS and an NZU price of $15–$20 temporarily (until 2012) created an increased incentive for afforestation. However, the carbon price has since fallen and present afforestation rates are lower.[5] *For pre-1990 forests, ongoing deforestation of approximately 3000–5000 hectares per year is expected to continue if the carbon price remains at current levels, all other things being equal.*[6]

NZ ETS incentives to afforest or to avoid deforestation are partially linked to the price of emission units. Any changes to demand in the NZ ETS will affect NZU prices. Aspects of the NZ ETS other than NZU prices are also important in incentivising forestry activities and encouraging foresters' participation in the scheme.

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4 For more information on how forestry works in the NZ ETS, visit www.climatechange.govt.nz

5 Afforestation was 4,500 hectares in 2013, as reported in New Zealand's Greenhouse Gas Inventory 1990–2013 www.mfe.govt.nz/climate-change/reporting-greenhouse-gas-emissions/nzs-greenhouse-gas-inventory

6 From MPI's 2013 and 2014 Deforestation Surveys www.mpi.govt.nz/news-and-resources/statistics-and-forecasting/forestry

These include regulatory certainty and confidence in the stability of the NZ ETS.

13 – Comment - Yes, policy instability and capricious changes have been a major problem.

Questions

13 How does the carbon price impact your forestry investment decision-making?

In your answer, we are interested in the:

a) *extent to which the NZU price impacts decisions, compared to other factors*

I. **The Ministry will get some qualitative responses here, but what officials really need to do is to do, or get done, some empirical analyses of:**

i. **The Price elasticity of demand for forestry and non-forestry units.**

ii. **The price elasticity of supply for units from various sources.**

iii. **The cross price elasticities of demand for and supply of land and units from dairy and forestry price fluctuations.**

iv. **These price elasticities should be analysed by a competent microeconomic analyst, so that there is real information, not just qualitative accounts from people.**

b) *impacts of the current price, and of your expectations for future prices.*

I. **People will be second guessing government policy on this – you'll need to know what their expectations are based on and also whether they are referring to prices within the New Zealand ETS trade or whether they expect interantional units to be traded across the NZ borders.**

14 Are there opportunities for the NZ ETS to increase incentives for forestry investments, outside of NZU price? ***Yes/No/Unsure***

14 Yes. There are several opportunities.

14.a One is that emissions could and should be charged for by agriculture. That would help to internalise the carbon budget for agricultural production – at least on the consumption of emissions producing inputs, though the output emissions would still not be covered.

14.b The New Zealand ETS could incorporate the issue of NZUs for carbon sequestration in native ecosystems and also for requirements for surrender of NZUs for harms to native ecosystems that result in emissions. As long as NZ trades are no longer linked to the international units trades, NZ can use emissions trading to promote biodiversty gains and to slow or avert losses. We should recognise the carbon sequestration from conservation measures, and allow those who achieve documented

conservation gains from whatever methods to be rewarded with emissions units. NZ has to reduce emissions, but the means by which this is done is up to us.

15. What are your reasons for the above answer? If you answered yes, we would be interested in comments on:

a) any barriers to participating in the NZ ETS that could be reduced

i) Capricious policy changes could be stopped.

ii) Native ecosystems and Permanent native forests sinks, wetlands, tussock grasslands, marine ecosystems and others could be rewarded with NZUs whilst those who threaten these or who release methane clathrates could, and should, be penalised with surrender obligations.

iii) the "cap" – or quantity limit on emissions should be made real and rigorous.

15 b)other factors.

People wish for fairness in policy and also want mutual assurance. They also need to see that there are social norms supporting policy-desired behaviour. The government could pay attention to these matters.

International units

Due to our national circumstances, New Zealand has fewer low-cost options to reduce our domestic emissions compared with other developed countries.

Comment: This is spin. If we included agriculture, and contemplated how farmers might change the nature of their farming, adjust to a low input farming regime, and / or changed from ruminants to other species, animal or vegetable, then we could substantially reduce emissions. The "sacred cow" and the perception that there is no alternative is a creation of vested interest lobbying. It is not a given, it need not go on belching and peeing greenhouse gas emissions. There ARE alternatives to dairying and to the high-input farming regimes. These are still profiable and may do less damage to the environment. The Ministry should be monitoing shifts in production and inputs to dairying while prices are low to understand the scope for such changes and new paradigms of production, as well as the price elasticity of supply.

Access to international abatement through the opportunity purchasing international emission reduction units and counting them towards our target allows New Zealand to take more ambitious emission reduction targets. From the perspective of mitigating climate change, emission reductions achieved anywhere in the world will ultimately benefit all countries. Linking the NZ ETS with international carbon markets means New Zealand businesses face similar costs for emission reductions to those faced in other countries. This is why the NZ ETS has accepted international units in the past, and will likely accept international units in future.

While international units are of critical importance for New Zealand meeting its international climate targets, they have also contributed to challenges in the NZ ETS. Until June 2015, NZ ETS participants had no limit on the number of international units they could import and surrender. This contributed to a significant drop in the value of NZUs, as the majority of units available on the international market were available at much lower cost, and reduced incentives for carbon

abatement in New Zealand. The high number of international unit surrenders contributed to the creation of the stockpile of banked NZUs, and was one of the reasons why the Government decided that from June 2015 the NZ ETS would only accept NZUs for surrender, becoming a domestic-only scheme.

Given the importance of international abatement for meeting our 2030 target, the Government is likely to consider making international units eligible in the NZ ETS once again. This will require assessment of whether to place any limits on the use of international units, and of whether and how to balance the tension between providing access to lower cost abatement while promoting stable development of the carbon market in New Zealand, particularly given that international carbon markets may remain volatile for some time.

Question

16. *If international units are eligible for NZ ETS compliance in the 2020s, should any of the following restrictions be placed on their use?*

    a) *restrictions on where units can be sourced from (location of and/or types of projects)*

    YES, and in particular, only high quality, independently certified international units should be permitted. There should be no use of "hot air" credits. The government should have controlled the use of "hot air" units years ago.

    The BAU estimates will usually be junk in themselves, so there should have to be measured emissions reductions, not simply assumed reductions.

    b) *restrictions on how many units can be surrendered*

    Yes, and this should be no more than 10% of international units per surrender, the rest should be NZUs. Controls should include that there are verifiable GHG emissions reductions or sinks associated with the units surrendered.

    c) *others (please explain).*

Auctioning

We are interested in your views on whether selling NZUs by auction should be introduced and what the role or purpose of auctioning should be. Auctioning mechanisms are part of several overseas emissions trading schemes, and there are provisions in the NZ ETS legislation that allow for the introduction of an auctioning mechanism.

In emissions trading schemes overseas, auctioning mechanisms are primarily used as a way to efficiently distribute units to participants and ensure the number of units circulating reflects the emissions cap on the scheme and/or the national emissions reduction target. They can also be used to influence unit prices by controlling the supply of units.

Auctioning was not part of the original NZ ETS design. In 2012 the NZ ETS legislation was amended to allow the Government to make regulations to sell NZUs by auction, within an overall limit on NZUs that would determine how many units could be auctioned each year. This limit could be used to align the supply of non-forestry NZUs in the NZ ETS more closely with our international target. Auctioning could also be used to influence NZU prices, by providing more units to the market or through using features such as reserve prices.

The large number of banked NZUs means that there is enough unit supply to allow participants to meet NZ ETS surrender obligations in the near future. This weakens the case for the Government selling NZUs by auction in the short term, particularly as it could risk increasing the stockpile of banked units. However, in the medium-to-long term it could be used to better align the NZ ETS with our climate change targets.

Implementing a mechanism to sell NZUs by auction would be a major design change to the NZ ETS. Determining the role or purpose of auctioning is the first step for deciding whether, and how, to introduce auctioning of NZUs to the NZ ETS. This includes clarifying the role of auctioning NZUs as a source of units, taking into account other sources such as forestry, banked units, and international units, both now and post-2020.

There are other issues that also need to be considered, including how to set the NZU limit that determines the amount of units that can be auctioned each year, and detailed auction design settings. If a decision to introduce auctioning is made, we would consult on these issues before implementation. Developing an auctioning mechanism would take at least 18 months, meaning that it is a medium- to-long term prospect, rather than a short-term option.

Questions

17. *Should auctioning be introduced in the NZ ETS?*

Yes

YES, but NZ needs to look not only at the annual flow of auctioned units but also the stock of units. The stock of units banked may not be all available for matching for surrender of emissions, since those who have banked them will be making their own assessment about future expected prices compared with the cost of holding them.

If yes, when?

a) *in the next two to three years*

Yes, but only if quantity limits are observed. In the next 2-3 years and thereafter, though the auction quantity need not be the same each yerar. The quantity available should depend on the success of the price signal and other measures, including regulatory and social norm measures in reducing emissions at an accelerating rate.

The benefit of auctioning is that there is a payment to the Crown and the revenues can be used for public purposes, instead of there being a free allocation to emitters. Free allocations are a subsidy to emitters and a wealth transfer from society to those who get these free allocaitons.

Some transitional assistance could be argued for in the past, but now, the severity of climate destabilisation, the extensive publicity about the need to reduce emissions, and the publicly known need for reductions mean that there is no reason to continute to cushion those who emit or who buy the products of emitters.

It will be important though to ensure that there is not a flood of auctioned units – only those sufficient to keep NZ within our reduction targets should be issued, and if need be, excess should be surrendered and retired.

b) *within five years (before 2020)*

c) *after five years (post 2020). Far to long.*

18. *What should be the role or purpose of an auctioning function in the NZ ETS, if one were introduced?*

a) to align supply in the NZ ETS more closely with our international target

YES – and to make REAL reductions. Yes a cap is required. This cap could be managed to limit emissions – so that there is a temporal limit on any "bank" term.

b) *to more actively manage NZU prices*

There is a short to medium term case for some degree of a managed transitional price path rise with both a price cap and floor, like a covered escalator. This should be strictly limited. The essence of a cap and trade system is to ensure that quantity is limited, so that the price can be determined by the market. A floor will help to keep investment stable.

Price controls or quantity Controls

You can't sensibly aim to manage both price and quantity – it is one or the other.

Price

If you manage the price long term, then you are open to being lobbied and firms will invest in such behaviour. You end up with a levy, and that is fine but it is hard to change. A carbon charge is a sound method – but lobbying is likely to reduce the charge to a socially suboptimal amount. The lobbying and other efforts by those who stand to gain from polluting and paying less than their share will be directed at the levy or at any maximum and minimum administered prices, if trading is allowed within a rising price band.

Quantity

A cap and trade regime relies on control of the quantity available. This then allows the price to be set – possibly within administered bounds – by the market.

These lobbying efforts will be to secure:

a) Exemptions for particular industries – like the "trade exposed" and agriculture industries. Such exemptions will be argued to be justified on a range of rationales – but if you give in to these arguments, you are subsidising the high carbon path of the industries concerned, you will encourage distorted investments and eventually stranded assets.

You will also impose the costs on the climate and on tax payers and on other polluters who have to push much further up their marginal abatement cost curves.

b) A debasement of the quality of the emissions reductions and the available credits and offsets. This is exactly what has happened with the use of "hot air". Other debasement efforts will emerge, such as for other fake emissions reductions, less durable reductions, and other quality and durability erosions.

You can and should control the quality of the NZUs and the emissions reductions. The quantity cap should be enforced and the price left to find its own level.

d) *other (please explain).*

d The auctioning system has other advantages:

It provides a payment (in the form of a resource rental, in effect), for the use of a scarce resource – the right to emit greenhouse gases – and the funds acrue to the government. It might also be possible for the auction to be on behalf of those who already hold the units.

Auctions could also be subject to short or long term permits. A tonne of carbon equivalent ghg is essentially the same irrespective BUT methane and CO2 and other GHGs have very different global warming potentials and breakdown profiles. There is some merit in recognising these differences by varying the terms of the permits to match the durability of different GHGs.

It may also avoid the need to consider the use of resource rentals in free allocation.

19. *How should auctioned NZUs relate to other sources of unit supply in the NZ ETS, especially NZUs generated through forestry removals and/or international units?*

The primary role of the supply of NZETS should be in emissions abatement-reduction certified units, with strict controls on the quality of certifications.

International Units should not be accepted until there is a well established quality control of high standard. New Zealand has already besmirched its reputation by allowing hot air to be accepted. We need to focus on incentivising genuine emissions reductions at home to meet – and exceed – our emissions reductions commitments. Further delays will continue to entrench our laggardly ways and to mute incentives to reconfigure the economy and consumption to low carbon options. This has a debilitating effect on low carbon technologies and practices.

Forestry removals should be available, but any quantity auction should take account of the whole budget of carbon emissions and be confined to NZ's emissions reduction requirements. There is no scope for increasing emissions, the goal must be for a reduction path that hastens reductions in emissions faster and more effectively than NZ's feeble commitments so far.

Provisions for carbon credits for protecting native biodiversity and soil carbon can be part of the New Zealand scheme – so long as we meet our overall reduction targets consistent with the Paris agreement and provisions. There is a huge benefit to the climate and to our native ecosystems to be had from incentivising such protection and regeneration.

4.4 Managing price stability

We are interested in views on whether and how the Government should influence carbon prices in the NZ ETS over the medium-to-long term.

To limit price increases or spikes, the NZ ETS has a $25 fixed price surrender option but it does not have a mechanism to limit price decreases. However, as seen since 2012 significant price drops are possible. This potential for price instability may reduce the effectiveness of the NZ ETS in driving investment decisions to reduce or remove emissions. An NZU price floor would protect against significant price drops, and provide businesses with more clarity on the carbon prices they may face in future. It could also:

- *provide benefits to foresters, if it provides a minimum guaranteed price for forestry units at a level that incentivises afforestation*
- *increase the costs of participants' surrender obligations by keeping carbon prices above a certain level.*

With the current design of the NZ ETS, implementing a price floor would be challenging and expensive for the Government. The simplest way to establish a price floor would be for the Government to have a standing offer to buy NZUs at the floor price. This would require the Government to purchase units.

If the Government decides to take a more active role in managing the supply of NZUs through auctioning, it may have more scope to influence the price of units. Some other emissions trading schemes have price floors implemented through reserve prices for units auctioned into the market. In New Zealand, this approach would not provide a fixed price floor for all NZUs, as there are other sources of NZU supply such as forestry, but it would ensure no auctioned NZUs are provided to the market below a certain price. It could be combined with a price cap to provide a 'price corridor' to help limit price volatility in both directions. In some other emission trading schemes, these price caps and floors are scheduled to step up over time to provide a gradually increasing range of carbon prices.

Questions

20. What impact has carbon price volatility in the NZ ETS had on your business?

a) *minor*
b) *moderate*
c) *significant.*

N/A, but clearly price volatility has been a big problem for some. Others have invested in lobbying instead for exemptions.

We favour a rising escalator of price path, but consider that there must be measures to safeguard the public purse as well.

It is a moot point whether governments would in fact be willing to stand in the market and buy NZUs. This method was intended for the fisheries Quota Management System, but in fact, fishers wrangled compensation and the $50m plus budget of the needed buy back led to ministers quailing at the prospect and the buy back never happened.

21. *Do you think measures should be in place to manage price stability?* ***Yes/No/Unsure***

YES, with in the medium term an adminisntered rising price path within a band but with a rigorous quantity cap with quality controls so that expectations of increasing emissions prices are both created and maintained. In the long term, as the economy is decarbonised with technical and practice changes and regulatory controls take effect, the long term marginal costs of abatement should decline and with it the price of emissions reduction if the marginal cost of emissions reductions decreases. Decarbonising the economy should include measures such as banning opening new coal mines and oil wells, genuine emissions testing on vehicles and appliances, provision of public transport options, social norm changes and carbon smart urban planning and technical changes.

22. What do you consider are important factors for managing price stability?

a) *upper price limits (eg, fixed price option, or a price ceiling implemented through an auctioning mechanism)* – **YES but with an administered price floor and ceilng, NOT by means of an increase in the quantity cap.**
b) *lower price limits (eg, price floor)* **YES**
c) *other (please explain).* **A rising price path, a credibly fast rising track, and officials and ministers who resist self-interested lobbying by those who want to stave off paying the full price and making full adjustments to their decisions.**

23. What should the Government consider when managing price stability?

Creating and maintaining expectations of emissions units scarcity and price incentives to reduce emissions, without making investment in reductions or sequestration too risky.

4.5 Operational and technical matters

The NZ ETS has now been in operation since 2008, and we continue to identify areas for improvement from an operational and technical perspective. Participants are asked to give their views on how the operational and administrative efficiency of the NZ ETS could be improved. We

anticipate providing a technical note at a later stage that describes operational and technical issues that have been identified through the operation of the NZ ETS to date.

Questions

24. *Are you aware of ways the administrative efficiency of the NZ ETS could be improved?* **Yes**

From an economic efficiency point of view, the key thing is to spread the scope to all sources of emissions and to maintain quality.

25. Can you provide further information to support your answer? We would be interested in comments on:

a) *complexities involved in NZ ETS participation*

b) *penalties for breaching NZ ETS obligations*

c) *any technical or operational changes that could be made to the NZ ETS to improve efficiency.*

4.6 Addressing barriers to the uptake of low emissions technologies

The Government's main policy response to reducing emissions is the NZ ETS. However the NZ ETS alone will not drive New Zealand towards a low emissions economy. The carbon price incentive from the NZ ETS will generally encourage the efficient uptake of opportunities and technologies for reducing emissions. However in some sectors or cases, there may be other barriers or market failures that also need to be addressed. For example:

- *lack of information*
- *high upfront costs of new technologies*
- *lack of infrastructure to support new technologies*
- *unnecessary regulatory barriers to new technologies.*

Ultimately the transition to a low emissions economy will require changes that come from all sectors of the economy. Where the Government can play a useful role it has implemented policies, targets and programmes outside of the NZ ETS that will contribute to reducing emissions. These other policies are needed where there are additional barriers to adopting low carbon technology, or where the Government has a role in encouraging innovation. Key initiatives include:

- ***Energy efficiency**, through investment in programmes run by the Energy Efficiency and Conservation Authority aimed at improving energy and fuel efficiency in industry and households.*
- ***Public and active transport**, with over $1 billion allocated to public transport through the National Land Transport Fund, and $100 million for cycling through the Urban Cycleways Fund.*
- ***Electric vehicles**, by exempting electric vehicles from road user charges until 2020.*
- ***Science and research**, for example, investing approximately $10 million annually in research for new agricultural mitigation technologies through the Pastoral Greenhouse Gas Research Consortium and the New Zealand Agricultural Greenhouse Gas Research Centre.*
- ***Renewable energy**, through the New Zealand Energy Strategy 2011–21 and target for 90 per cent of our electricity to be from renewable resources by 2025.*

- ***New forest planting**, through the Government's afforestation grant initiatives, such as the Afforestation Grant Scheme and the Erosion Control Funding Programme in the Gisborne District.*

There may still be other areas where the NZ ETS will not drive the uptake of emissions reduction opportunities, even if carbon prices increase significantly. We would like your help to identify these, and on whether there is a role for Government in addressing any barriers that exist.

Please note that while this NZ ETS review may identify issues or opportunities to support emissions reductions in sectors where the impact of the NZ ETS is limited, they may need to be addressed through other processes.

1. Questions

26. Are there any barriers or market failures that will prevent the efficient uptake of opportunities and technologies for reducing emissions?

a) **Government failures and market failures are both in play.**

I. The non-rival and non-excludable (public good) benefits of carbon retention and sequestration in native ecosystems and soils are not recognised nor incentivised, and neither are ecosystem services, so these are largely neglected. Introduction of payments and investment incentives to encourage these is needed urgently.

II. Externalisation of costs, calling the internalisation of such costs a cost increase, and shifting the costs of abatement onto those who cannot alter the emissions should not be tolerated by public policy. Instead, public policy should work to be plain where there are emissions generated and seek to tackle these sources, or make any subsidies in the form of non-payment for emissions explicit.

27. If so, is there a role for the Government in addressing these barriers or market failures and how should it do this?

i) YES. The government's roads of significance to National and special housing areas have embedded private transport options and urban forms that are socially, economically and environmentally sub optimal. Given this, public policy should focus on the following in respect of transport and urban form:

a. Speeding up the introduction of electric and hyrbid vehicles by means of better consumer information, lower introduction costs (Norway has shown the way), public funding of recharge stations for long range travel whether these are plugs or batteries, requirements for cities to provide these too.

b. Insisting on true fuel efficiency ratings on vehicles – many of the ratings are pure fiction ;

c. Emissions testing and reporting as part of warrant of fitness checks;

d. Far more provision of public transport, safe and sheltered waiting spaces, better information and frequency for these.

e. **Far more investment in active transport. The amount cited fails to compare it with what has been spent on more roading.**

f. **More investment in rail transport to keep it viable and to recognise the negative externalities saved from moving freight from road to rail.**

Ii) More regulation to insist on better insulation and to require that building standards maintain the health standards of buildings, whether these are public or private, tenented or otherwise. The health spending on, and suffering of ,those in such buidlings will reduce, providing a doublre dividend. Market and government failures are present, and government regulatory intervention is justified.

iii) Much of the psychology and social literature shows that altering social norms is critical for behavioural change. Attention to this and measures to give people the information and example of adoption of new ways is required. There is plenty of literature on this and academics and the policy literature can provide guidance if there is political will to do this.

Iv New coal mines should not be permitted, and instead, Fonterra, hospitals and other coal users should be penalised for the use of fossil fuels and encouraged to use wood pellets and other renewable fuels, where design changes cannot relieve the need for heating.

vi) Better provision of public fiunding for reliable and well routed public transport in rural areas as well as small towns and urban areas is needed. This may be enabled for instance, with some coordination funding for community transport or coupling funding to business and community groups to assist in making passenger and goods transport able to connect with whatever is already happening.

vii) Many of the consumer requirements may be helped by government helping with reducing information costs. Sometimes this may relate to information centres, but probably such coordination may need to be web-based. Ride sharing sites could be better publicised, public transport timetables and frequency information could be improved for small towns and rural areas as well as cities, Expedia-style coordinated information should be available for public transport and freight information. This will reduce transport information costs to both consumers and to businesses, and so will reduce the frequency of people just hopping in their private transport.

viii) Aircraft and shipping fuels should be subject to emissions charges and reporting.

ix) There are many other roles for government – reducing information costs, monitoring and reporting, providing regulatory rules so that the scope for freeloading is reduced, attending to the export of Greenhouse gas emissions, and so much more could be done.

ECO thanks you for the attention to this submission. We are grateful for the opportunity to submit.

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