New Zealand ETS review 2015/16 consultation

Copy of your submission

1. Do you agree with the drivers for the review?

Answer 1: Yes

2. What other factors should the Government be considering in this NZ ETS review?

Answer 2:
The role of other policies in creating a high income, high quality of living, low-carbon future for New Zealand. Some of these may be additional price signals; some may be regulatory; some may be facilitative policies such as R&D signals. But the Government should think about climate policy in a more rounded and coherent fashion.

3. Should the NZ ETS move to a full surrender obligation for the liquid fossil fuels, industrial processes, stationary energy and waste sectors?

Answer 3: Yes

3A. Please explain your answer: This seems obvious.

4. What impact will moving to full surrender obligations have on you or your business?

Answer 4:
$50 would probably have quite a significant effect, especially regarding housing decisions. We are intending to move anyway, and would probably make distance to work a more central feature of our choice than if climate policy remains weak. The lower the price, the weaker those incentives.

5. If full surrender obligations are applied, when should this be implemented?

Answer 5: a) 2016

Outline the reasons for your answer, and include any comments on the pros and cons of applying an increased surrender obligation to a partial or a full NZ ETS reporting a year. Strike while the iron is hot and the oil price is low.

6. If the NZ ETS moves to full surrender obligations, should potential price shocks be managed?

Answer 6: No

6A.Please explain your answer:
Two times a small number is still a pretty small number. I don't really see a case for managing these "shocks" given the uncertainty and volatility that businesses routinely manage in commodity prices, etc. There's a much stronger case for managing potential "shocks" through floor and ceiling prices.

7. If potential price shocks associated with moving to full surrender obligations should be managed, how should this be done?

Answer 7:

7A. Please explain your answer:

8. If the $25 fixed price surrender option value should change, what should it change to and why?

Answer 8:

9. Do you consider the future cost of emissions in your business planning?

Answer 9: Yes

9A. How do you do this?
Expectations about increasing carbon prices/declining fossil industries form part of my decision framework when it comes to housing, investment, mobility etc.

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

Answer 10:
Some sign that the Treasury and Cabinet take this problem seriously and understand that global efforts will increase rather than stay flat.

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

Answer 11:
There's a paper somewhere that argues/shows that one of the reasons that policies are often less effective and efficient than they could be is because politicians use policy instruments to reward friends and penalise opponents. Free allocation within an ETS is a perfect example. Free allocation is a good way of purchasing political support for policies which would otherwise involve unpalatable shocks to industries (such as fishing) when cap & trade is brought in, but over time the need to purchase that support declines. In the medium-long run free allocation should be replaced by auctioning, since polluters should pay - that's the point.

Also, leakage effects are not real at these prices - certainly not at $20-$30/t. Leakage effects may be very real in non-CO2 industries such as semi-conductor manufacture and in very large, complex sectors such as aviation. But firms contemplating moves in response to NZ's ETS should consider their moves carefully - it's not clear how much of the developed world will have no carbon price in the 2020s. Moving, for most, would be an expensive bet on medium-term policy, and we are seeing the back-makers of climate policy in the Anglophone world being rolled (Abbott, Harper). The costs of moving to non-Anglophone countries are high for most NZ companies given our country's language skills. It's possible that a whole bunch of NZ firms fleeing a carbon price seek carbon asylum in Singapore, but unlikely - and even if they did it's quite plausible that Singapore might price carbon sometime in the next 15 years.

In other words, leakage concerns are double-edged in a world with dynamic policy settings. Staying brings prices; moving brings costs, and uncertainties regarding future prices.

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?

Answer 12:

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

Answer 13:

14. Are there opportunities for the NZ ETS to increase incentives for forestry investments, outside of NZU price?

Answer 14: Yes

15. What are your reasons for the above answer?

Answer 15:
Floor price. I've heard $15/t, but you could make it $20/t to make sure. If you offer a floor price to satisfy foresters, and a ceiling price to calm heavy CO2 users - setting a collar also limits the risks associated with volatility, and helps with depoliticising the issue.

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

Answer 16:

- a) restrictions on where units can be sourced from (location of and/or types of projects)
- b) restrictions on how many units can be surrendered

16A. Please explain your answer:
(1) The units need environmental integrity.
(2) A necessary condition for stopping the warming is stopping the (net) CO2 emissions. Given the cases other countries can make, it's extremely unlikely that NZ will convince anyone that we should be a net source of (significant per capita) CO2 emissions in the second half of this century. So part of what the ETS should do is get us on a path to a genuinely low carbon future. Only domestic reductions work towards that goal, which is, as I say, a necessary condition of stopping warming.
(3) The fraction of domestic vs international mitigation (the "restrictions" in your formulation above) need not stay fixed over time. It could start with weak domestic obligations and ramp up over time (especially in response to evidence that others were mitigating) and/or it could vary with oil prices so that climate policy's effects are to maintain pressure in times of weak oil prices but give consumers some relief in times of high oil prices - if you assume that international mitigation is cheaper than domestic mitigation then increasing the opportunity to do cheap mitigation when oil prices are high helps soften peak prices. I think. That might be practically hard, I guess, but I think it works in theory.

17. Should auctioning be introduced in the NZ ETS?

Answer 17:

17A. Please explain your answer:
Presumably this is a logical step at some point. Free allocation should gradually be phased out. See above.

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

Answer 18: c) other

18A. Please explain your answer:

Equity, domestically. In the long-run, polluters should pay, not receive windfalls if they pollute a little less.

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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?

Answer 19:

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

Answer 20:

20A. Please explain your answer:

21. Do you think measures should be in place to manage price stability?

Answer 21: Yes

21A. Please explain your answer:
Floor and ceiling. Floors prevent bad outcomes in the forestry sector; ceilings limit the burden of climate policy in a world of very uneven carbon pricing.

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

Answer 22:

- a) upper price limits (eg, fixed price option, or a price ceiling implemented through an auctioning mechanism)
- b) lower price limits (eg, price floor)

22A. Please explain your answer:
See Holt and Shobe, Price and Quantity “Collars” for Stabilizing Emissions Allowance Prices: An Experimental Analysis of the EU ETS Market Stability Reserve. Resources for the Future Discussion Paper.
See also Fankhauser and Hepburn, Designing carbon markets. Part I: Carbon markets in time, Energy Policy Volume 38, Issue 8, August 2010, Pages 4363–4370, which includes the following:

"Fourth, other price management policies, such as allowance reserves, auction reserve prices or hard price ceilings and/or floors, could be potential policy options to reduce price variance between commitment periods and increase dynamic efficiency and “when” flexibility. However, these policies create obstacles that will make linking much more difficult. Given that dynamic efficiency should be achievable in systems with long enough commitment periods and appropriate banking and borrowing, these
additional interventions may be seen as second-best policy alternatives to setting appropriate long-term targets in systems with banking and limited borrowing."

Price management idiosyncrasies might help domestically, but they may hinder the linking of markets, which is

presumably something that's important to NZ in the long-run. I think the message here is "yes, floors and ceilings are useful, but keep an eye on what others are doing so as not to kill future options for joining up."

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

Answer 23:
International practices in other carbon markets. If we can get out there and tout our model to other markets, especially in the developing world, we can make it easier in the long run to link with other markets - the more other ETS resemble ours, the easier it is to link. So helping others create markets (that resemble our own) lowers our own future costs in a more joined-up world. That's why helping create developing country carbon markets is in our own self-interest.

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

Answer 24:

25. Can you provide further information to support your answer?

Answer 25:

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

Answer 26:
Yes.

Polluters do not need to reflect the full externalities of their pollution in the prices they pay. ETS prices are one way of trying to get them to reflect these externalities, but currently prices do not do this. There are some good reasons prices are low, but as long as they are low, then there is a strong case for other policies which also attempt to reduce pollution.

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

Answer 27:
Yes.

(1) If (a) carbon prices are expected to increase over time, and if (b) the full prices of pollution are not reflected in carbon prices, and if (c) investments today do not factor in these expectations, then there is a case for up-front fees for large capital expenditures which lock you in to a high carbon trajectory. Example: Fonterra's boilers will be fossil burning. These commit Fonterra to a long-term high carbon trajectory. At the time they install the boilers, Fonterra will be paying a lower price now than will hold over the lifetime of the boilers (because of a) and a lower price than is justified on the basis of their pollution (because of b). If their investments do not factor these in (c) - and why would they? - then there is a case for some sort of up-front fee to reflect the fact that across the lifetime of the plant a higher (possibly considerably higher) price on carbon will hold and is justified. Basically - you should tax people where they are making high carbon commitments today, and where low current prices are not reflecting pollution externalities.

(2) R&D policies and facilitation policies that make it easier to live high income, high quality of life, low carbon lives. New initiatives on electric cars are welcome. Enhanced public transport in some areas would also be a good idea. Better building standards would have climate co-benefits. The agricultural focus of R&D in NZ is understandable,

but something of a red herring - whatever else we know, we know we need to stop CO2 emissions. CH4 emissions can wait*. Ch4 emissions reductions are not a substitute for CO2 emissions** - so if you are funding methane mitigation research *instead of* CO2 mitigation then you are making a bad choice in terms of limiting warming.

*See Bowerman et al, "The role of short-lived climate pollutants in meeting temperature goals" Nature Climate Change 3, 1021–1024 (2013) doi:10.1038/nclimate2034.
** Pierrehumbert, "Short-Lived Climate Pollution" Annual Review of Earth and Planetary Sciences Vol. 42: 341-379, 2014, which says "Eventual mitigation of SLCP can make a useful contribution to climate protection, but there is little to be gained by implementing SLCP mitigation before stringent carbon dioxide controls are in place and have caused annual emissions to approach zero. Any earlier implementation of SLCP mitigation that substitutes to any significant extent for carbon dioxide mitigation will lead to a climate irreversibly warmer than will a strategy with delayed SLCP mitigation. SLCP mitigation does not buy time for implementation of stringent controls on CO2 emissions."

28. Please comment here

Answer 28:

Name Dave Frame

Organisation (if applicable) VUW

Address
[redacted]

Telephone [redacted]

Please enter your email address to receive a copy of your submission [redacted]