



19 February 2016

File Ref: EXOF-6-37

NZ ETS Review Consultation
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Dear NZ ETS Review Consultation

Submission: New Zealand Emissions Trading Scheme Review 2015/16

Thank you for the opportunity to comment on the review of the New Zealand Emissions Trading Scheme. The Greater Wellington Regional Council (GWRC) welcomes the chance to engage with the New Zealand Government on the priority issues being considered during this initial round of consultation.

GWRC has developed a Climate Change Strategy, which aims to strengthen the long term resilience and sustainability of the Wellington region through climate change mitigation, adaptation, and awareness-building actions. Like many other councils in New Zealand and around the world, GWRC wants to demonstrate strong leadership and commitment to addressing emissions at the sub-national level. However, local government's ability and mandate to reduce emissions is limited and the legislation makes clear that responsibility for regulating GHG emissions sits with central government. As the governments principal policy tool for addressing climate change, it is important that the ETS is able to send clear policy signals and achieve significant emissions reductions.

Please feel free to contact [REDACTED] if you have any questions about the submission.

We look forward to the next stage of the review.

Yours sincerely

[REDACTED]

Greg Campbell
Chief Executive

[REDACTED]



To: Ministry for the Environment

Submission: New Zealand Emissions Trading Scheme Review 2015/16

From: Greater Wellington Regional Council

Thank you for the opportunity to participate in the review of New Zealand's Emissions Trading Scheme (NZ ETS), the latest of three formal reviews to be undertaken since the NZ ETS came into effect in 2008. The Greater Wellington Regional Council (GWRC) welcomes the chance to engage with the New Zealand Government on the priority issues being considered during this initial round of consultation: moving to full surrender obligations and managing the costs of moving to full surrender obligations.

GWRC has an interest in the delivery of a well-functioning and effective emissions pricing mechanism operating across different sectors of the New Zealand economy. GWRC agrees with the Minister's comments in the Discussion Document that New Zealand firms and households need to have greater confidence in the NZ ETS policy settings now and in the future. GWRC also agrees that this review must help ensure that the NZ ETS is well-placed to support New Zealand's transition to a low emissions economy and that, as far as practicable, emissions costs are borne by polluters (Discussion Document, p.1).

This submission provides responses to the questions posed in the Discussion Document, discusses the relevance of the NZ ETS settings for our organisation's activities, and proposes ways in which the Government could address issues of uncertainty and improve the performance of the scheme towards meeting its objectives.

Q1 Do you agree with the drivers for the review?

GWRC agrees with the drivers for the review and we have commented below in relation to each. In addition to the four drivers identified in the Discussion Document, we have also outlined several other factors that we believe the Government should be considering as part of the review (refer to Question 2).

NZ ETS performance against objectives

GWRC notes that, in addition to the two objectives of the NZ ETS identified in the Discussion Document (page 8) and set out in the Climate Change Response Act 2002 ('assisting New Zealand to meet its international obligations', and 'reducing New Zealand's net emissions below business as usual levels'), the Government has outlined three other high-level objectives for the ETS:

- help New Zealand to deliver its 'fair share' of international action to reduce emissions, including meeting any international obligations;
- deliver emission reductions in the most cost-effective manner;
- support efforts to maximize the long-term resilience of the New Zealand economy at least cost¹.

¹ New Zealand Government, 2012; Ministry for the Environment, 2013

Assessment criteria for each of these three high-level objectives are outlined in a Ministry for the Environment Regulatory Impact Statement Report (2012). Criteria for the ‘Delivering fair share’ objective include enhancing New Zealand’s international credibility and providing incentives to abate. GWRC notes that these criteria have not been met, with New Zealand only meeting its first commitment period target under the Kyoto Protocol through reliance on the use international offsets and short-term forestry absorption, not through reducing its gross emissions, which are increasing.

The lack of a limit on the use of United Nations offsets, which has allowed ETS participants to acquire the cheapest, and in some cases lowest quality, offshore emissions units, has caused concern internationally about the integrity and environmental effectiveness of the NZ ETS². The ability to purchase cheap units from offshore, many of which may not have resulted from genuine emissions reductions, according to a report released by the Stockholm Environment Institute last year, removes the economic incentive for emissions abatement among domestic emitters³.

Among the Government’s criteria for achieving the ‘Long-term economic resilience’ objective are that the NZ ETS should:

- provide incentives for the long-term development of low-cost emission abatement technologies
- maximise equity between sectors and socio-economic groups
- promote intertemporal equity, and
- minimise negative/ maximize positive wider environmental impacts.

Under current settings, it is now very clear that there are few incentives to invest in decarbonisation as the price signal is too weak to spur behaviour change or investment in abatement technologies, and major emitters are either shielded from the full cost of their emissions or exempt from the scheme entirely.

Rather than promoting equity between sectors, the oil, coal and dairy industries are in effect being subsidised while renewable energy is not, and forests are being converted to intensive agricultural uses because the price of carbon is not sufficient to drive new planting or deter deforestation. Considering that New Zealand’s strategy for meeting its international emission reduction commitments relies so heavily on carbon dioxide removals from land use change and forestry, this is concerning. Emitters do not have to face the full cost of their actions and this debt is being passed on as a disproportionate burden for future generations to deal with.

The contribution of the scheme in its current form to ‘minimising negative/ maximizing positive wider environmental impacts’ seems to have been limited given the negative impacts associated with the deforestation that is occurring under current ETS settings, including habitat loss, soil degradation and erosion, and the impacts of conversion of forest land to intensive agricultural uses such as nitrate leaching into waterways, increased methane emissions and pressure on surface and groundwater for irrigation.

Preparing for a more carbon-constrained future

² see for example Mundaca and Richter, 2013 and Rocha et al, 2015

³ Kollmuss et al, 2015

The NZ ETS is the Government's principal policy tool for addressing climate change. The ability of the ETS to achieve significant emissions reductions must therefore be one of the most important measures by which to evaluate the success of the scheme. GWRC believes that the lack of an overall quantitative restriction on the use of international offsets has undermined the ETS' effectiveness in preparing New Zealand for a carbon-constrained future by driving down the value of New Zealand units (NZUs) to the point where there are very low levels of investment in a low-carbon economy.

As noted in section 2.2 of the Discussion Document, the Intergovernmental Panel on Climate Change estimates that average global carbon prices will need to be around NZ\$90-178 per tonne over the 2020s if the goal of limiting temperature increases to below 2 degrees is to be realised. Due to current settings for the NZ, the current (and historic) price of NZUs is well below that.

The Discussion Document (page 9) states that the costs associated with achieving New Zealand's 2030 target should fall on those responsible for the emissions, not the general taxpayer. However, at present only 55% of total emissions are being covered by the scheme and, of those sectors that are included in the ETS, some have received free allocation of NZUs. In addition, emitters in all sectors except forestry can surrender units covering only 50% of their emissions due to the '2 for 1' compliance measures introduced in 2009. Instead of these 'transitional measures' being phased out, they have been retained indefinitely and were applied to new sectors entering the scheme in 2013. The continuation of free allocations for the industrial sector has removed what would have created an initially small but incrementally (annually) increasing pressure on industrial emitters and large energy consumers to reduce emissions⁴.

GWRC also notes that, despite the ETS Review Panel's recommendation in 2011 that the agricultural sector should enter into the scheme in 2015, the Government has excluded agriculture from the ETS indefinitely. Although the biological emissions from the agricultural sector comprise close to half of New Zealand's total emissions, the introduction of surrender obligations for the agriculture sector are not being considered as part of the current review because the Government does not consider it economically viable and does not believe practical technologies to reduce emissions are available (page 5).

The Government's 2012 amendments to the ETS diverged significantly from the ETS Review Panel's recommendations and rather than prioritising emission reductions, the amendments instead focused on easing the shorter-term burden on businesses and households. This has compromised the potential for the ETS to successfully prepare New Zealand for a more carbon-constrained future.

The longer we delay reducing emissions, the harder and more expensive it will be, and GWRC would like to see all emissions from all sectors considered as part of the review of the ETS.

Increasing certainty about future policy settings

GWRC is supportive of the Government's intention to increase certainty and confidence in the NZ ETS by making clear decisions on if, when and how transitional measures will be phased out, and whether selling NZUs by auctioning will be introduced. The extensive changes to the NZ ETS design, encompassing a number of amendments that have delayed its full implementation,

⁴ Richter and Chambers, 2014, p.59

have created uncertainty among investors and participants in the scheme. Confidence in the ETS among foresters in particular appears to be low and this is demonstrated by the lack of afforestation occurring under the ETS. The 2012 deforestation survey⁵ found that the ETS scenario leads to higher rates of deforestation than a non-ETS scenario.

The lack of a sufficient and predictable price signal to provide some certainty about future costs and to create an incentive for low-carbon investments is a significant issue. While the introduction in 2012 of the \$25 price cap provides certainty about the highest costs of compliance for emitters, no such certainty exists in terms of a price to stimulate investments in decarbonisation. \$0-25 is a wide price range within which planting and other investments can be economically viable or not.

We note that the Iwi Leadership Group proposed the introduction of a price floor, which would be a 'potentially proportionate and symmetrical policy response' to a price cap. Price floors are part of the design of a number of emissions trading schemes internationally, including in California and Quebec and featured in the original design of the Australian carbon pricing mechanism. An effective floor price can be introduced into an ETS by setting a reserve price in allowance auctions. This automatically leads to a reduced quantity of allowances being made available in the market if the price is below the reserve, because some allowances remain unsold, and there is thus a greater reduction in emissions compared with the original cap in the event of excess supply.

GWRC submits that the establishment of an independent and adequately-resourced regulatory authority to advise on the ETS and emission reduction targets should be considered. Examples of similar authorities elsewhere include the Australian Climate Change Authority, the UK Committee on Climate Change and the European Commission⁶. Such an arrangement may help to overcome some of the uncertainty and unwieldiness stemming from the currently complex institutional arrangements and the powers of interference of the minister, the inventory agency and other parties.

Managing banked emission units

As discussed earlier, a consequence of NZ ETS settings to date, in particular the lack of any restriction on offset use, has allowed a huge number of cheap international units into the New Zealand Emission Unit Register. The problem of banked NZUs is also a symptom of the over-generous allocation of NZUs and the indefinite extension of 'transitional' measures intended to ease the burden of the ETS, which have come at the cost of driving emission reductions. The result - an oversupply of NZUs that have been issued but not used - will be mitigated to some degree by the fact that, as of mid-2015, international units are no longer accepted for surrender due to New Zealand pulling out of the Kyoto Protocol.

However, more action will be needed in terms of adjusting the settings of the ETS in order to manage the fiscal risk to the Government and ensure that the responsibility for reducing emissions is passed on to those generating the emissions. Some of the most obvious fixes on the demand side may be to announce the end to the 2 for 1 provision and reinstatement of phasing down the rate of free allocations. On the supply side, auctioning will most likely be required to

⁵ see Manly, 2013; Richter and Chambers, 2014

⁶ Richter and Chambers, 2014

tighten up the market and enable the NZ ETS to become the tool for decarbonisation it was initially intended to be. We note that on current settings, the NZ ETS (our country's key instrument for reducing GHG emissions) is estimated to reduce gross emissions by 0.4% in the year 2030, relative to what would happen if the Government took no action at all⁷.

Setting a cap on the total amount of emissions within New Zealand under the ETS may be necessary to create a credible price signal and regulate overall emissions within a given period of time. It is hard to see how New Zealand can fulfill its international commitments without such measures.

Q2 What other factors should the Government be considering?

There are several other issues that GWRC believes the Government should factor into this review. These issues are either not canvassed in the Discussion Document or, in our view, have not been given sufficient weight in the discussion.

Long term opportunities and benefits, not just short term costs

Commentary in the Discussion Document highlights the potential costs of moving to full surrender obligations, including an analysis of the increased financial impact on emitters that may result from them having to take full responsibility for their emissions. GWRC is concerned that the discussion focuses too narrowly on the financial burden that will be incurred by polluters if they have to face the full cost of their actions. This ignores the polluter pays principle, the basic economic idea that businesses or consumers should pay for the negative externality they create. Internalising the environmental externalities of economic activities, in this case the GHG emissions, through a credible price on carbon in the ETS, enables the prices of goods and services to fully reflect the costs of production.

GWRC believes that New Zealand has the ability to build on areas where it already demonstrates leadership and has natural advantages such as sustainable agriculture, forestry, bio-mass and renewable energy generation. These areas offer great promise for New Zealand both in terms of local innovation and as a knowledge export economy. Strengthening the NZ ETS to reflect the true cost of carbon is essential to spur investment in the right areas, realize new economic opportunities and pioneer solutions other countries need.

The costs of inaction

As noted, the emphasis in the Discussion Document is largely on costs and challenges for New Zealand in strengthening the ETS and decarbonising our economy. As well as the benefits and opportunities of reducing emissions mentioned above, we think it's important to highlight the likely costs of inaction, or of insufficient action, on climate change. The Intergovernmental Panel on Climate Change Fifth Assessment Report states that without additional mitigation efforts, warming will lead to a 'very high risk of severe, widespread and irreversible impacts globally'⁸, and that while mitigation involves risks, these risks are not as great as those from climate change. A 2015 report on 'The Cost of Inaction' published by The Economist Intelligence Unit concludes that "Impacts on future assets will come not merely through direct, physical harms but also from

⁷ Sustainability Council of New Zealand, 2014

⁸ IPCC AR5 Synthesis Report, 2014, p.7

weaker growth and lower asset returns across the board. The interconnected nature of the problem will reduce returns, even on investments unharmed by physical damage⁹.

While the costs of climate change impacts will be borne by all New Zealanders, the cost of insufficient action to reduce emissions is of particular concern for local government, given that councils have key responsibilities for climate change adaptation planning. Key risks for the Wellington region include sea level rise, exacerbating the effects of coastal erosion and flooding; increased frequency and intensity of storm events, adding to the risks from floods, landslides, severe wind, storm surge, coastal erosion and inundation; and increased frequency of drought, placing pressure on water resources and increasing the risk of wild fire.

The Wellington region has seen a number of unusually severe weather events over the past few years, and such events will become more frequent and intense with climate change. For organisations like GWRC with responsibilities for flood protection operations and maintaining regional public transport services and infrastructure, responding to major climate events is likely to become increasingly challenging. For smaller or more remote councils, and communities with limited resources and capacity, climate change adaptation may become prohibitively expensive in the absence of effective measures to reduce emissions fast. As the principal policy tool for addressing New Zealand's GHG emissions, the ability for the NZ ETS to facilitate significant emission reductions, thus reducing future climate change impacts, is essential.

Accounting issues

We understand that although the New Zealand Government has decided not to bring forward a legally binding commitment for the Kyoto Protocol's second commitment period, it has stated that it nevertheless plans to apply Kyoto Protocol accounting rules governing the second commitment period. However, there are a range of other important Kyoto Protocol provisions that the New Zealand Government has decided it does not wish to have applied to itself. This raises some legal and ethical issues as the Protocol provides certain benefits that are intended only for Parties that have made a legally-binding commitment.

If New Zealand is able to apply its preferred accounting rules, even without agreeing to accept a legally-binding commitment under Kyoto's second commitment period, it will be able to carry over surplus units from the first commitment period, generate LULUCF (Land Use, Land Use Change and Forestry) credits during the second commitment period, and purchase Kyoto units from other parties. It has been calculated that if New Zealand is able to apply its preferred accounting rules and use these units to offset its fossil fuel and industrial emissions, its nominal 5% reduction by 2020 from 1990 levels pledge could in reality enable an increase in GHG emissions excl. LULUCF of 74-94% above 1990 levels. If the estimated 2013-2020 "surplus" units generated by New Zealand's proposed application of the Kyoto Protocol LULUCF rules were allowed to be carried over to the post-2020 period, then the 11% below 1990 GHG emissions excl. LULUCF reduction target in 2030 could actually become an 11% increase above 1990 levels. GWRC is concerned that this accounting approach would significantly decrease any action required from New Zealand to reduce emissions in its energy and industrial sectors.

The Government's intended strategy of using forestry offsets and international units to meet its commitments while actually allowing an increase in gross emissions is unsustainable given large

⁹ The Economist, 2015, p.4

amounts of forests are set to be harvested in the 2020s, and will therefore become a carbon source not a sink.

Biological emissions from agriculture

GWRC's view is that inclusion of emissions from the agricultural sector should be part of the scope of this review.

A broader policy framework for emission reductions

GWRC would like to see the NZ ETS supported by a broader emission reduction framework. Climate change has far-reaching implications for the economy, environment and society and therefore a multi-faceted response across sectors as well as across government ministries is required. We support making low-carbon policies a whole of government priority to ensure consistency in vision and approach across government departments.

GWRC also believes that this issue requires cooperation across the political spectrum and efforts to engage all New Zealanders in the solutions. Depoliticising the issue of climate change through stable climate policy supported by a cross-party working group would improve businesses' abilities to make good long term decisions. It would also benefit New Zealand by attracting investment in low carbon industries and innovation.

Emissions trading post-Paris

We understand that toward the end of negotiations in Paris, New Zealand presented a Carbon Markets Declaration that recognizes the important role of markets in the post-2020 period. Joined by at least 17 other nations (including the U.S., Australia, Canada, and several European nations), the New Zealand initiative will develop standards and guidelines for environmental integrity of global carbon markets.

While the final Paris agreement doesn't explicitly mention "markets", under it parties can voluntarily use ITMOs (Internationally Transferred Mitigation Outcomes) to help them meet the reduction targets set out in their Nationally Determined Contributions, while ensuring that transparency and the environmental integrity of the regime is maintained (Szabo, 2015).

Perhaps one of the most notable features of the language agreed is that the mechanism will deliver "an overall mitigation" in global emissions, which means it will differ from the offsetting concept established under Kyoto's Clean Development Mechanism. While it could be a few years before the new rules and procedures for international emissions trading are agreed, GWRC sees the initial focus on robust accounting rules and a shift beyond pure offsetting as positive. These are two of the issues that we believe have undermined the integrity and effectiveness of the NZ ETS to date.

Q3 Should the NZ ETS move to a full surrender obligation for the liquid fossil fuels, industrial processes, stationary energy and waste sectors?

Yes. While sequestering carbon through forestry and land use change activities is important, a real and substantial reduction in emissions from all sectors needs to occur for New Zealand to transition to a decarbonised economy. The major focus of mitigation efforts needs to be on the main drivers of climate change: emissions from fossil fuels, agriculture and industry.

What is clear is that the more LULUCF credits are obtained, the less action is needed to reduce emissions i.e. the more sinks are counted, the less real reductions are required. New Zealand's use of LULUCF credits to mask a significant rise in emissions from other sectors is inconsistent with

a global 2 degrees Celsius goal, and, according to international commentators, ‘appears to have removed any signal that could have assisted the increasingly carbon intensive energy system in New Zealand to pursue a low carbon, transformational pathway’¹⁰.

Q4 What impact will moving to full surrender obligations have on you or your business?

GWRC’s purpose is to enrich life in the Wellington region by building resilient, connected and prosperous communities, protecting and enhancing our natural assets, and inspiring pride in what makes us unique. A number of GWRC’s operations and activities are particularly impacted by settings in the NZ ETS, as discussed below.

Land management

GWRC is responsible for protecting the productive capacity of land in the region and encouraging and promoting sustainable land management. We do this by encouraging landowners to recognise the economic and social value of managing land in a way that will protect the resource and meet the needs of this and future generations.

About 40% of the Wellington region is erosion-prone hill country. Hill country erosion has major implications resulting from loss of soil and nutrients, lost production, damage to houses, fences, roads, phone, and power lines, and damage to waterways (Ministry of Primary Industries, 2015). GWRC works with landowners to prevent or reduce soil erosion by improving the way the land is used, by planting trees, or by allowing native bush to grow in areas that are at risk from erosion. Large-scale afforestation, particularly of marginal and erosion-prone land, as well as avoided deforestation has been argued to be one of the most cost-effective ways of reducing net emissions, at least in the shorter term (Ministry for the Environment, 2008).

Under current ETS settings, the economic incentives for land owners to mitigate erosion and sequester carbon through tree planting are lacking. Exclusion of the agricultural sector reduces the likelihood that new forest sinks will be planted in New Zealand because marginal and eroding lands where it makes sense to plant trees for carbon sequestration are mostly owned by farmers.

Achieving the dual outcome of managing erosion and sequestering carbon through afforestation requires restricting access to international units in the NZ ETS. This would help ensure that those who emit GHGs either sequester them or pay other people to sequester them. It also requires that full surrender obligations be introduced. However, immediately imposing full accountability for emissions on all sectors would be very disruptive, and so gradually increasing the proportion of emissions that must be accounted for without giving any free credits is probably the best approach.

Transport

GWRC manages the Metlink public transport network in the Wellington region, which includes a comprehensive range of bus, train and harbour ferry services. GWRC is also responsible for a range of public transport infrastructure. GWRC’s aim is to build a world standard, low emission public transport network to take greater Wellington into the future. We want to become a smarter, cleaner region by encouraging more people to travel by bus, train and ferry, especially at peak times.

¹⁰ Rocha et al, 2015, p.19

Though fuel use in New Zealand has historically been relatively inelastic, it's expected that a higher price on carbon would have some influence on people's choice to walk, cycle or use public transport rather than travel by car. Increasing certainty about future policy settings in the ETS would also help to incentivise investment in decarbonising the economy, including investment in infrastructure for low carbon transport.

Strategic planning and infrastructure investment

GWRC has developed a Climate Change Strategy, which aims to strengthen the long term resilience and sustainability of the Wellington region through climate change mitigation, adaptation, and awareness-building actions. Like many other local government organizations in New Zealand and around the world, GWRC wants to demonstrate strong leadership and commitment to addressing emissions at the sub-national level. However, local government's ability and mandate to reduce emissions is limited and the legislation makes clear that responsibility for regulating GHG emissions sits with central government.

Political leadership and clear policy signals through the ETS and as part of a broader emission reduction framework are required to ensure councils can make sound long term strategic planning decisions and infrastructure investments. For GWRC, this includes planning and investment in key projects and assets such as flood protection infrastructure, bulk water supply infrastructure, regional land transport planning, and regional economic development.

Q5 If full surrender obligations are applied, when should this be implemented?

GWRC suggests that feedback from relevant sectors on this discussion document will give an indication of the impact of different timing scenarios. However, we note that the longer the delay reducing emissions, the harder and more expensive it will be.

Q6 If the NZ ETS moves to full surrender obligations, should potential price shocks be managed?

Our view is that managing the costs of full surrender obligations could be done through a staged process.

Q7 If potential price shocks associated with moving to full surrender obligations should be managed, how should this be done?

GWRC believes that potential price shocks should be managed by a gradual move to full surrender obligations, whereby the surrender obligation faced by participants increases incrementally over time.

Q8 If the \$25 fixed price surrender option value should change, what should it change to and why?

The best starting point for considering the question of a price cap may be to look at what the IPCC's models estimate global carbon prices need to be to limit global warming to 2 degrees, which, as previously noted, is in the range of NZ\$90-178 per tonne over the 2020s. We note that the \$25 fixed price surrender option was considered in the last review of the ETS in 2011 and at that time the Review Panel recommended that it be increased in steps up to \$50 by 2017. We no longer have the luxury of time to implement the Review Panel's initial recommendation for a staged increase in the fixed price option to 2017. However, a design that enables an increase over time should be implemented if carbon prices in the ETS are to rise to anything close to what the

models suggest is required. Consideration should also be given to the introduction of a price floor as a parallel measure.

Thank you again for the opportunity to comment on this review of the NZ Emissions Trading Scheme.

Greg Campbell
Chief Executive
Greater Wellington Regional Council