

Topics for NZ ETS Review 2015/2016 consultation

About the consultation

The Government is reviewing the New Zealand Emissions Trading Scheme (NZ ETS) to assess how it should evolve to support New Zealand in meeting future emissions reduction targets and its ongoing transition to a low emissions economy. This follows the announcement by the Government in July this year that New Zealand's post 2020 target is to reduce greenhouse gas emissions to 30 per cent below 2005 levels by 2030.

The Ministry for the Environment is leading the consultation and welcomes your feedback on how the NZ ETS is working and how it might work better in the future.

The review will focus on:

- some transitional measures introduced to moderate the impacts of the NZ ETS
- what is required for the NZ ETS to evolve with changing circumstances including future targets
- operational and technical improvements.

Discussion document

For more information about the consultation, read our discussion document. It sets out the issues on which the Government is consulting, the objective and drivers for the review. It also contains the terms of reference for the review.

Some transition measures are being given priority and have the first deadline for submissions as they may be candidates for legislative change in 2016 (see closing dates for submissions below). Refer to the discussion document for detail on the priority and other matters under review.

Technical notes on the following specific issues will be available in December or early 2016 to support submissions:

- modelling of the impacts of the priority issues outlined in the discussion document
- forestry sector matters, including accounting methodologies for post-1989 foresters
- operational and other technical matters.

To be notified of when these technical notes are available, please email nzetsreview@mfe.govt.nz.

Closing dates for submissions

- Submissions on priority issues close at 5pm on 19 February 2016
- Submissions on other review matters close at 5pm on 30 April 2016.

You may make submissions on both priority issues and on the other matters. If you provide feedback on both you can do so in a single submission or separate submissions. Please note submissions on priority issues must be received by 19 February 2016.

Publishing and releasing submissions

All or part of any written submission (including names of submitters), may be published on the Ministry for the Environment's website www.mfe.govt.nz. Unless you clearly specify otherwise in your submission, we will consider that you have consented to website posting of both your submission and your name.

Contents of submissions may be released to the public under the Official Information Act 1982 following requests to the Ministry for the Environment (including via email). Please advise if you have any objection to the release of any information contained in a submission and, in particular, which part(s) you consider should be withheld, together with the reason(s) for withholding the information. We will take into account all such objections when responding to requests for copies of, and information on, submissions to this consultation under the Official Information Act.

The Privacy Act 1993 applies certain principles about the collection, use and disclosure of information about individuals by various agencies, including the Ministry for the Environment. It governs access by individuals to information about themselves held by agencies. Any personal information you supply to the Ministry in the course of making a submission will be used by the Ministry only in relation to the matters covered by this consultation. Please clearly indicate in your submission if you do not wish your name to be included in any summary of submissions that the Ministry may publish.

Contact for queries

Please direct any queries to:

Phone: +64 4 4397400

Email: nzetsreview@mfe.govt.nz

Postal: NZ ETS Review Consultation, Ministry for the Environment, PO Box 10362, Wellington 6143

Questions to guide your feedback

The questions below are a guide only, and all comments on topics are welcome.

To ensure your point of view is clearly understood, please explain your rationale.

Contact information

Name	Jenson Varghese and Peter Nunns
Organisation (if applicable)	MRCagney Pty Ltd
Address	Level 4, 12 O'Connell Street P.O. Box 3696 Shortland Street, Auckland 1010, New Zealand
Telephone	██████████
Email	██

Submission Form

Context and drivers for the review

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

Yes

No

x

Unsure

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

We agree that it is important to make a rapid decision on whether and how to move to a full surrender obligation, as this has a significant effect on the prices that emitters face. We also acknowledge the importance of the other issues in the review.

However, there are two important exclusions from this review.

The first is that it does not address the issue of when all sectors will be included in the ETS. In particular, agriculture appears to have been indefinitely excluded from the scope of the ETS in spite of the fact that it accounts for a large share of NZ's overall emissions.

The second is related to this. Given that some sectors have been excluded, no consideration has been given to how the ETS can influence firms' and households' *marginal* investment decisions. Even if free emissions units are gifted to firms that have existing emissions, there is no reason to provide those firms with free units to expand their emissions. In other words, an ETS can still influence firms' marginal decisions about emissions and investment even if it provides free allocations to cover existing activities. That won't necessarily result in a reduction in emissions, but it will discourage them from rising further in the future.

Moving to full surrender obligations

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

Yes

x

No

Unsure

The one-for-two surrender obligation amounts to an additional subsidy for new and existing emission sources. It increases the degree to which greenhouse gas emissions are underpriced relative to their social cost and hence encourages firms and households to invest in carbon-intensive activities.

While there was a case to include it as a transitional measure, prior reviews recommended transitioning to a full surrender obligation prior to 2016. This change is necessary if the ETS is to be successful in its stated purpose of reducing New Zealand's greenhouse gas emissions.

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

Please include specific examples or evidence of the impacts on you or your business of:

- a) increased carbon prices, including actions to reduce emissions and future investment decisions. Please comment on effects that may occur at carbon prices ranging from \$5 to \$50, including any evidence of actions taken previously when carbon prices were higher.
- b) any NZ ETS administrative or operational issues, for example the option for participants to apply for a unique emissions factor.

MRCagney was established in 2001 as a specialist transport and planning consultancy and has since grown to employ more than 50 staff from our offices in Australia and New Zealand. The company is wholly-owned by Australian and New Zealand employees and is committed to making a positive, long term contribution to the communities in which we operate. MRCagney is a leading public transport consultancy highly respected for its city and region-wide public transport network and service strategies and plans.

Due to the nature of our business, an increased carbon price will have little or no negative impact on our business. We do not currently invest in any greenhouse gas-intensive activities, meaning that our primary exposure to carbon prices comes as a result of domestic and international air travel to work with clients throughout Australia and New Zealand.

If anything, we would expect an effective ETS to have a positive impact on our business. A higher carbon price would tend to incentivise increased use of public transport, walking and cycling and thus would increase demand for our transport planning and advisory services. Having a “thicker” domestic market may also build local skills and expertise and make New Zealand a more competitive exporter of transport planning services.

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

- a) 2016
- x
- b) 2017
- c) 2018
- d) other – please specify

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 year.

Previous reviews have already delayed the timing of full surrender obligations, resulting in uncertainty around the long-term prices faced by emitters. A longer lead-time for changes will increase the risk of indefinite postponement of full surrender obligations. Consequently, we support a shorter implementation time-frame.

Managing the costs of moving to full surrender obligations

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

Yes

No

Unsure

x

This depends upon what you mean by "price shocks". We do not support measures that delay *increases* to carbon prices under the ETS, as the current prices are too low to appropriately price in externalities associated with greenhouse gas emissions. Prices should be allowed to rise from their current low level.

However, we are open to measures to manage *volatility* in future prices, if that is a credible risk. In saying this, we note that a primary driver of volatility in NZ and international carbon prices has been government policy reversals. Consequently, it is of primary importance to achieve rapid certainty about how soon all sectors will be included in an ETS, which (if any) international credits will be accepted, and how high prices will be allowed to rise in the future.

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

a) maintain the fixed price option at \$25

x

b) lower the fixed price option

c) gradually move to full surrender obligation

d) other methods.

X

See response to question 6. The most important thing that government can do to give certainty to the market and avoid price fluctuations is to give a clear direction about key elements of ETS design. Consequently, we support rapid resolution of other issues in the scope of the current review, as well as other issues that remain outside scope (see response to question 2).

We are skeptical of the case for a fixed price option at \$25, as this is below current estimates of the social cost of greenhouse gas emissions documented in the consultation materials. If maintained, this would lock New Zealand into a pattern of subsidising polluters. This is not likely to be necessary to maintain competitiveness, given that many models assume that NZ's trading partners will move towards a higher carbon price.

Consequently, if the government seeks to maintain a fixed price option the fixed price should be allowed to increase over time, with a clear path set out at the outset and a considerably higher end-point.

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

See response to question 7. If a fixed price surrender option is seen as necessary, we would argue that the fixed price should begin at \$25 and gradually increase (over a period of 10-15 years) to somewhere in the range of \$100-200.

If the rationale for a fixed price surrender option is to prevent extreme price volatility, the cap should not be set at a level too low to be effective. We note comments in the consultation document that average carbon prices would need to be in the \$90-178 range to have a sufficient effect on global warming.

Other issues: business responses to the NZ ETS

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

Yes

x

No

If yes, how do you do this?

We do not invest in greenhouse gas-intensive activities. As a result, the main impact on our business is due to employee's travel behaviours. To mitigate these impacts, we are located in an area that is accessible by public transport, walking, and cycling to allow employees alternatives to driving.

As we work throughout New Zealand and internationally, it is sometimes necessary to fly for work. Where possible, we attempt to minimise air travel by teleconferencing and working remotely.

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

As indicated above, our main exposure to the ETS is as a result of air travel within Australia and New Zealand. Much of this travel is international and hence may be inherently difficult to cover in a national ETS. We do not expect our domestic competitiveness to be adversely affected by inclusion of emissions from domestic flights, as most competitors would face the same costs. Consequently, while it may be helpful to have better information on the future path of carbon prices, we do not expect this to have a large effect on our activities.

Other issues: protecting competitiveness through free allocation

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

We support reducing free allocation rates after 2020 regardless of other policy changes. Free allocation to emitters in specific sectors is likely to distort investment decisions, potentially locking New Zealand in to an emission-intensive economy on an ongoing basis. This may result in economic risks in the future: as other countries adopt higher carbon prices, New Zealand's export competitiveness may be placed at risk.

However, if it is not possible to reduce free allocation rates across the board, there are several things that Government can do to reduce the distortions created by free allocation. First, it can allow the price of emissions units to rise by moving to full surrender obligations and raising the cap on the emissions price. This will increase the financial incentive for reducing emissions and selling excess emissions units.

Second, it can ensure that free allocation is not available for increases to emissions-intensive production over and above current volumes. This will help to ensure that firms' marginal investment decisions take negative externalities into account.

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?

It would have little or no negative impact on our investment decisions. See response to question 9 above.

Other issues: managing unit supply - forestry

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

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

N/A – we are not a forestry business.

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

Yes

No

Unsure

x

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
- b) other factors.

The key barrier to increased participation of forestry in the ETS – and net reforestation to enable a supply of new emissions units – is the current low price for emissions units. Some of the changes within the scope of this review are likely to increase the emissions prices and hence ameliorate this barrier. However, long-term policy certainty is required to manage the risk that emissions prices fall to low levels again in the future. (See response to question 6.)

Other issues: managing unit supply – international units

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)

We support integration of the ETS with similar schemes overseas. However, repeating the earlier experience of allowing international units without considering factors that may have distorted their prices is unlikely to result in an effective ETS. Consequently, we would prefer careful management of where units can be sourced, with an aim to primarily trade with countries that have achieved a relatively stable market with prices that are (a) not below the current prices prevailing in the NZ ETS, as these are already very low, and (b) generally moving towards the price of \$90-\$178 that would be required in order to prevent the worst effects of climate change.

Furthermore, we would be in favour of suspending trading with overseas schemes if they changed their ETS in such a way as to reduce emissions prices below current levels.

- b) restrictions on how many units can be surrendered
- c) others (please explain).

Other issues: managing unit supply – auctioning

17. Should auctioning be introduced in the NZ ETS?

Yes

No

Unsure

x

We are open to moving towards an auction system. In principle, we would prefer units to be auctioned rather than freely gifted to emitters, as this would allow for better price discovery in the market as well as increasing the economic efficiency of the initial distribution of units. Doing so would require other complementary changes, such as a cap on the annual allocation of units. However, there are some risks to implementation in the short term, as noted in the consultation documents.

If an auctioning mechanism were to be adopted, we would support setting a sinking lid on the number of emissions units that could be allocated annually. In light of New Zealand's international obligations, this cap should be based on our agreed commitments to reducing carbon emissions.

Increased emissions prices can play an important role in incentivising these changes. As a transport consultancy we believe that New Zealand has good domestic opportunities to reduce emissions. A large share of New Zealand's greenhouse gas emissions come from transport. Both existing technologies (public transport, bicycles, more fuel efficient cars) and new technologies (hybrid and electric vehicles, ICTs) offer significant scope to reduce emissions, both by enabling different transport behaviours and by improving the efficiency of the vehicle fleet.

If yes, when?

a) in the next two to three years

b) within five years (before 2020)

c) after five years (post 2020).

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

x

b) to more actively manage NZU prices

x

c) other (please explain).

x

See response to question 17. The key benefits of an auction system would be (a) better ability to set a cap that is in line with our international obligations to reduce emissions, (b) better price discovery and efficiency of unit allocation, and (c) the ability to set a reserve price to limit downward volatility in prices.

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?

Auctioned NZUs should have the same status as other emissions units in the scheme, subject to quality controls, e.g. on international sourcing.

Other issues: managing price stability

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

- a) minor
- x
- b) moderate

- c) significant.

See response to question 9 above.

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

Yes

No

Unsure

x

As discussed above, a major source of price volatility in the past has been uncertainty about government policy. Providing policy certainty, including a credible commitment to rising emissions prices, is the key measure that is required to manage price stability. In doing so, we also note that some useful changes to the scheme in the future, such as opening up to trade with other countries and any changes to unit allocation mechanisms, may result in some price uncertainty in the short run. It may be difficult to manage this risk.

We would be open to investigating measures such as price floors to manage downward volatility in prices, as this may discourage the supply of emissions units from forestry. We would prefer implementing a price floor through an auction mechanism – as a reserve price – rather than providing direct fiscal support.

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)

- b) lower price limits (eg, price floor)
- x
- c) other (please explain).

See response to questions 8 and 21. We support increases to the current price ceiling of \$25, with the intention of ensuring that the price ceiling is no lower than the \$90-178 range that is likely to result in sufficient emissions reductions to avoid the worst impacts of climate change.

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

A primary consideration when choosing how to set price floors/ceilings is ensuring that they do not make the ETS ineffective at achieving its aim of reducing New Zealand's net emissions.

It would also be reasonable to consider short-run impacts on the competitiveness of trade-exposed sectors and on household budgets. However, these interests are not necessarily best served over the long run by keeping prices low, as low prices will reduce incentives for innovation and investment in low-carbon technologies that will allow for living standards and competitiveness to be maintained over the longer term.

Other issues: operational and technical matters

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

Yes

No

x

Unsure

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.

N/A – we are not involved in administrative aspects of ETS compliance.

Other issues: addressing barriers to the uptake of low emissions technologies

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

We believe that there are a number of institutional barriers to faster uptake of opportunities for reducing emissions. In the transport space, there are a number of existing technologies that would allow New Zealand to reduce its emissions, such as rapid transit technologies, electric and hybrid vehicles, walking and cycling, and ICTs.

Some key barriers to increased uptake include:

- Transport investment frameworks that prioritise road investment over investment in lower-carbon modes of transport, rather than considering all solutions on an equal basis
- A lack of congestion pricing / road tolling on urban roads, which “under-prices” road journeys by failing to account for the marginal impact of congestion on other road users and hence encourages excessive driving
- A failure to measure some important transport outcomes, such as perceived safety of roads for pedestrians and cyclists, which affect mode choices
- Urban planning policies that restrict the density of residential development, limit the development of mixed residential / business areas, and require developers to provide free carparking in most areas

- Distortions in the tax system, such as the fringe benefit tax exclusion for employer provided carparking but not for public transport passes, that unintentionally subsidise carbon-intensive transport behaviours.

Some of these factors, such as urban planning policies, have long-term effects that may be slow to unwind even after the policies have been changed. However, as climate change is a long-term challenge, it is important to act on both the short-term and long-term barriers to change.

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

There is a role for the Government to remove barriers to uptake of low-carbon transport options. In some cases, such as transport investment frameworks, this may entail adjusting its approach to investment. There are already some good examples where this has occurred, such as the Government's Urban Cycleway Fund, announcement of support for Auckland's City Rail Link, and implementation of the Public Transport Operating Model, which is expected to increase the efficiency of bus services.

In other areas, this may mean intervening to address market failures, such as unpriced congestion, or taking action to address government failures arising from the unintentional consequences of other policies such as minimum parking requirements.

Any other comments related to issues set out in the discussion document

28. Please comment here

When your submission is complete

Email your completed submission to nzetsreview@mfe.govt.nz or post to NZ ETS Review Consultation, Ministry for the Environment, PO Box 10362, Wellington 6143.

Submissions on Priority issues close at 5.00pm on 19 February 2016.

Submissions on Other matters close at 5.00pm on 30 April 2016.