



13 June 2023

Ministry for the Environment
Manatū mō te Taiao
PO Box 10362, Wellington 6143, New Zealand

Via: Citizen Space.

Dear Ministry for the Environment,

Re: Annual updates to the New Zealand Emissions Trading Scheme limits and price control settings for units 2023

We welcome the opportunity to make a submission in relation to the proposed updates to the New Zealand Emissions Trading Scheme limits and price control settings for units for the period between 2024-2028.

This submission was written on the traditional lands of the Worimi and Awabakal people, and to that end, we acknowledge the Traditional Custodians and pay our respects to Elders past, present and emerging.

This submission is intended to be made public. Below we address questions 2, 5, 7, 10, 11, 13, 15, 16, 17, 18, 19, 20, and 22.

2. Do you think that the proposed update to auction volumes to reflect a change in forestry emissions outside the NZ ETS is sufficient to allow unit settings for 2024 and 2025 to be updated?

Yes. Data received by the Commission in December 2022 indicates an increase of approximately 69% in post-1989 forest in the NZ ETS. This means that a larger amount of post-1989 forest will earn units for emissions removals within the NZ ETS, increasing the NZUs stockpile and impacting the emissions budget for non-NZ ETS sectors. Section 30GB(5)(b)(i) of the Climate Change Response Act 2002 (the Act) allows for updates to the NZU settings for 2024 and 2025 in special circumstances where “a change that has significantly affected any matter that the Minister was required to consider under section 30GC when recommending the limits and price control settings that are to be amended”. Among the matters to be considered by the Minister are the anticipated volumes of greenhouse gas emissions to which the ETS applies and volumes of greenhouse gas emissions to which the ETS does not apply (Section 30GC(5)(a)(i)(ii)); as well as the proper functioning of the NZ ETS (Section 30GC(5)(b)). The latter (Section 30GC(5)(b)) becomes relevant if the Commission’s recommendations for updates to the



reserve price (Option four, Table 13) are not adopted from 2024 onwards (See our answer to question 15).

5. Do you think that updates to NZ ETS unit settings for 2024 and 2025 should occur if NZUs from the cost containment reserve are sold at the June NZ ETS auction? Note, the Commission recommends that settings for 2024 and 2025 are updated in this situation.

Yes. Section 30GB(5)(a) of the Act explicitly allows for the amendment of NZ ETS unit settings for 2024 and 2025 if NZUs from the cost containment reserve are sold in 2023. This is because the auction volume must induce scarcity, which is compromised where additional units are made available. If NZUs from the cost containment reserve are sold at the June NZ ETS auction, the loss of environmental integrity must be at least partially mitigated by updating the NZUs settings for 2024 and 2025.

7. Do you think that an update to calculations, and a corresponding reduction in auction volumes, should be made to reflect this updated estimate?

Yes. The updated estimate is relevant to two of the seven steps: Step 2 (allocation of emissions budgets to NZ ETS and non-NZ ETS sectors) and Step 5 (addressing unit surplus).

10. Should a new sub-step be added this year to address projected impacts on surplus stockpile liquidity rather than addressing it through annual updates to estimates of surplus stockpile liquidity?

Yes, the proposed sub-step will ensure that the NZ ETS remains aligned with emissions budgets.

11. Should adjustments to auction volumes be made to address historic actions?

We believe that a clarification around the use of the expression “historic actions” in question 11 is warranted, to prevent ambiguity. To be clear, in 2022 the Commission has recommended adjustments to the auction volumes to account for discrepancies between the GHG Inventory and the NZ ETS, as well as information on industrial free allocation and forestry units. “Historic actions”, in this question, refers to the Minister’s decision in 2022 of not adopting the Commissions’ recommendation. The data has been confirmed and the surplus stockpile volumes are accumulating over time, creating uncertainty on the environmental effectiveness of the NZ ETS. Therefore, while this portion of the surplus stockpile volume could have been corrected in 2022 (hence the use of the expression “historic actions”) the discrepancies are still current, rather than “historical”. With this clarification, our answer to question 11 is yes.



13. To what extent do you believe that increasing the CCR trigger price would influence NZU prices? Do you think that this influence would remain if CCR trigger prices were increased more significantly?

Previous auctions have seen NZU clearing prices steadily rising from below the CCR trigger (June 2021), to very close to the CCR trigger price (September 2021, March 2022 which coincided with an increase in the trigger price), to considerably above the CCR trigger price (December 2021, June 2022, September 2022). However, in December 2022 the clearing prices started to plummet, and the recent March 2023 auction was declined due to bids not meeting the confidential price reserve. Therefore, there is no sufficient evidence of the correlation between the CCR trigger price and the NZU clearing prices. It is likely that other factors, including the total auction volume and international ETS unit prices, will have a stronger influence on NZU prices in the future. However, in case concerns about the influence of the CCR trigger price persist, it is likely that a sufficiently higher CCR trigger price would reduce interference and allow the market to discover the prices within a normal price range.

15. What do you think of the proposed auction price floor settings? What impacts do you think will result from different settings?

Plunges to very low allowances prices can remove innovation incentives and reduce government revenues for mitigating distributional impacts from the ETS (See our answer to question 22). Hence, we have previously recommended an auction reserve price of approximately 80NZD/t in 2020 as a pragmatic way to prevent these negative environmental impacts (Sven Rudolph and Elena Aydos, *Carbon Markets Around the Globe: Sustainability and Political Feasibility*, Edward Elgar, 2021). The NZ ETS 'status quo' reserve price of \$35.90/t in 2024 is well below our recommendation. The Commission's recommendations (Option four, Table 13 of the consultation document) are better aligned with international prices (including the EU ETS) and our Sustainable Model Rule (*Rudolph and Aydos, 2021*).

16. Do you think the cost containment reserve should be disabled by having no reserve volume?

Yes, especially at current trigger prices. In order to achieve cost efficiency and preserve the environmental effectiveness of the NZ ETS, the auction volume must induce scarcity. The cost containment reserve adds a layer of ambiguity to the market and removes predictability in terms of meeting New Zealand's emissions budgets.

17. If retained, do you think the cost containment reserve should consist of one or two tiers?

As mentioned in our answer to question 16, we recommend that the cost containment reserve should be disabled in order to strengthen the environmental and economic



sustainability of the NZ ETS. However, in case the cost containment reserve is retained due to reasonable concerns on the impact of price hikes on households and the economy, the Commissions' recommended two-tier structure seems to be the most sustainable approach.

18. If a technical adjustment is included as part of the stockpile reduction component of auction volumes, should this technical adjustment amount be included in the total cost containment reserve volume?

No. Increasing the CCR volume would risk counteracting the intended benefits from the technical adjustment if the CCR is triggered.

19. If a multi-tier cost containment reserve is progressed, how should the volume of units in these tiers be decided on?

Our primary recommendation is that the cost containment reserve should be disabled in order to support the environmental and economic sustainability of the NZ ETS. However, in case a multi-tier cost containment reserve is progressed, the volume of units in the tiers should be deducted *ex-ante* from the auction volume, and distributed according to the Commission's recommendation, i.e. a lower tier comprising around a third of the total CCR volume.

20. What do you think of the proposed cost containment reserve trigger price settings? What impacts do you think will result from different settings?

"From an economic efficiency perspective, price management raises a risk of interfering with the optimal allocation of emission rights and abatement measures and thus impedes static cost-efficiency and innovation incentives, particularly if the price corridor is not carefully set" (*Rudolph and Aydos, 2021*). Of the options presented in the consultation document, the Commission's recommended low and high triggers (Options Four and Five, Table 16 of the consultation document) are the only options that offer sufficiently high trigger prices to limit the risks and impacts of the price controlling mechanism.

22. What role should price controls play in containing the level of impacts, and what price control settings would be required for this?

We have previously advocated that to serve social justice as well as climate justice, detrimental social effects caused domestically by the implementation of an ETS should be primarily mitigated by earmarking ETS auction revenues (*Rudolph and Aydos, 2021*). Intra-generational justice is best served by using allowance auction revenues for compensating low-income households and disadvantaged communities for the possible regressivity of higher energy prices. This approach is also in line with redistributive welfare-based justice concepts. Intra-generational national justice with respect to compensating polluters for extra



burdens is best dealt with by adding flexibility mechanisms to the ETS, such as the use of banking, reliable offsets, a sufficiently high price ceiling, and linking. In terms of the role of price control, Governments must be cautious with market interventions. Still, we agree that the Commission's recommendations in Table 13 (Option Four) and Table 16 (Options Four and Five) can prevent detrimental economic efficiency, environmental effectiveness, and social and climate justice impacts of unreasonable price spikes and plunges, while avoiding interference with market functioning in the normal price range.

Thank you for the opportunity to contribute this submission.

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