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Submission on the *Proposed changes to NZ ETS and SGG levy regulations 2021* consultation document

Ministry for the Environment

Submitted online at <https://consult.environment.govt.nz/comms/proposed-nz-ets-changes2021/>

## Submission on the Proposed changes to NZ ETS and SGG levy regulations 2021

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### Introduction

1. Energy Resources Aotearoa represents people and firms in the energy resources sector, from explorers and producers to distributors and users of natural resources like oil, LPG, natural gas and hydrogen.<sup>1</sup>
2. This document constitutes Energy Resources Aotearoa's submission to the Ministry for the Environment on its *Submission on the Proposed changes to NZ ETS and SGG levy regulations 2021* consultation document.
3. This submission covers why we support the Emissions Trading Scheme and some other matters including impact on business, international units, and how the ETS could be amended to help enable carbon capture and storage. We also answer specific questions in relation section 1.2 *Update auction price control settings* and section 2.2 *Update the DEFs for natural gas* of the consultation document. **Appendix One** refers to which paragraphs address specific relevant questions.

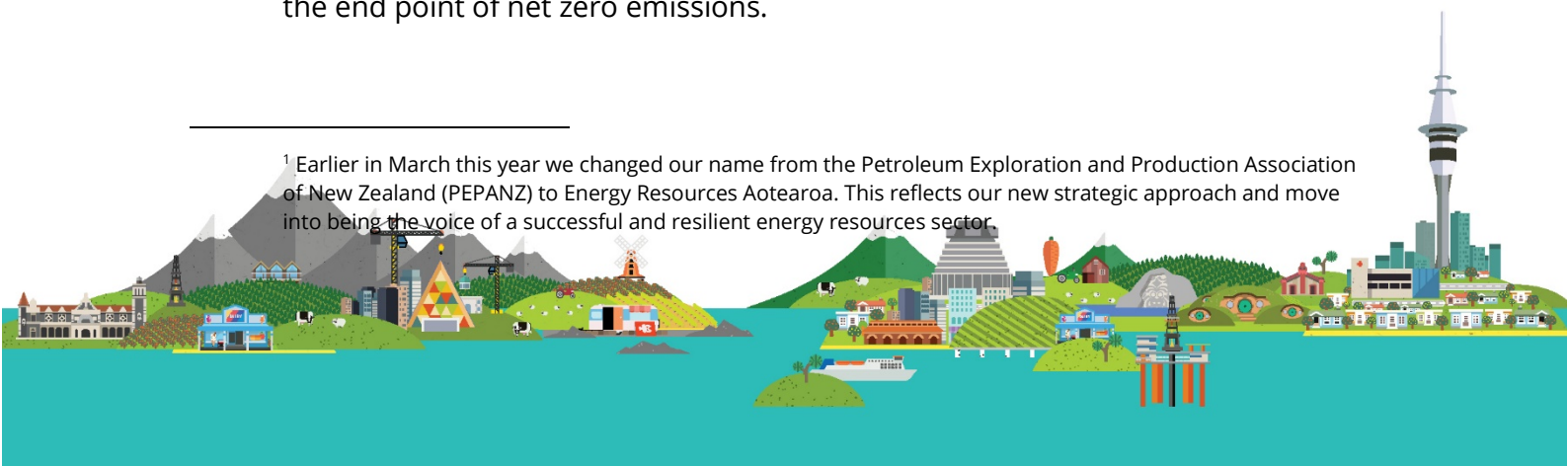
### Submission

#### We support the goal of net-zero emissions

4. We unequivocally support the objective of transitioning to a low emissions economy. The status quo emissions makeup needs to change, and we agree on the end point of net zero emissions.

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<sup>1</sup> Earlier in March this year we changed our name from the Petroleum Exploration and Production Association of New Zealand (PEPANZ) to Energy Resources Aotearoa. This reflects our new strategic approach and move into being the voice of a successful and resilient energy resources sector.



## Consultation process

5. We note that this departmental consultation was released shortly after the Climate Change Commission (“CCC”) received submissions on its draft advice. As a matter of good process, we consider the CCC should have been given time to deliver its final advice (scheduled for 31 May this year) before departments put out new proposals concerning emission reductions.
6. A key tenet of the CCC’s work is that it is independent and can provide relatively objective advice, and giving it the chance to do so would help to promote the bedding in of the CCC as an institution. Instead however, the Ministry’s proposals in its consultation document cut across the CCC’s work, and makes it difficult for stakeholders to understand how emissions policy is shaping and where it is being driven from. A cacophony of various and competing signals is making optimal decision-making increasingly difficult.

## The ETS is the Best Policy tool to Solve the Problem of Reducing Emissions

7. We would like to briefly recap our view on why the ETS is the best tool for reducing emissions and express our firm support for it.
8. An ETS is a proven way to solve the environmental externality problem associated with greenhouse gas emissions. Emitters are made liable for their emissions and face a price incentive to either abate their emissions or obtain more carbon credits. Consumers of goods and services that involve emissions in turn face price increases where the emitter has to meet emissions costs.
9. Economist William Nordhaus was awarded the Nobel Memorial Prize in Economic Sciences in 2018 for his work demonstrating that carbon pricing is the most efficient tool for reducing emissions. Nordhaus found that carbon pricing:
  - a. sends signals to consumers about which goods and services are more carbon-intensive;
  - b. sends signals to producers about which activities are most carbon-intensive (such as coal burning) and which are less carbon-intensive (like solar or wind);
  - c. sends signals to propel innovation to find new, affordable alternatives; and
  - d. ... is the best means to convey these signals within well-functioning markets.<sup>2</sup>
10. Emission reductions must ultimately happen at the level of the national economy, and not just in particular sectors as promoted by certain sectoral interventions. In considering this point, it is critical to bear in mind that New Zealand has just recently (and rightly) instituted a genuine cap and trade scheme. This emissions cap means a new and important dynamic in climate economics must be carefully considered – the ‘waterbed effect’.
11. The waterbed effect is an analogy showing that under a capped system, regulations further to the ETS cannot reduce overall emissions, because ‘pushing

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<sup>2</sup> <https://www.iisd.org/articles/nordhaus-nobel>

down' on one part of the 'waterbed' (through a sector-specific ban for example) means that the displaced set of emissions simply 'pops up' somewhere else in the economy as the overall volume of emission units does not change.

12. Some people claim the ETS is insufficient or inadequate, but we are becoming concerned that it is not being given the room to actually do its job, free from other 'complementary measures' or adjustments to the ETS regime itself. Ongoing support for the ETS cannot be expected to endure if the actions of policy makers continues to undermine its efficacy and then point to undermined effectiveness as a reason to support even more changes to undermine it further.
13. It is important that the ETS continues to enjoy wide support. Durable climate change policy is essential for ensuring stability and predictability of policy settings for consumers and firms. Without political stability behind climate policy, economic actors will likely delay making important actions to reduce emissions, or they will raise prices as risk is factored in.
14. If the government undermines the ETS with direct measures without providing any robust evidence, it sends a strong signal that the ETS can be diluted again in future. This would severely undermine confidence in the ETS by the public and investors who we need to make the capital investments in the technology we require for the transition.

### **Importance of considering the impact on businesses**

15. The consultation document notes that the carbon price rose by over 40% in 2020 alone. We would anticipate adverse economic consequences and a lumpy transition if New Zealand's carbon price or regulations continue to increase faster than substitutes fuels become affordable and available at scale. If too severe we will see job losses and the closure of firms.
16. Should exporting firms close, the risk of carbon leakage arises. Although dependent on circumstances, this cannot be disregarded as a serious unintended consequence of aggressive emissions policies.
17. Not all countries have fixed nationally determined contributions and corresponding enforced domestic emission caps. This has direct implications for the likelihood of leakage from firms that we work with in the energy resources sector. For example, in the scenario of New Zealand methanol no longer being produced by Methanex here due to emission pricing imposts, it is most likely that production will simply shift to China. This is because in the Asian market, Chinese production of methanol from coal is the next cheapest on the cost curve after New Zealand's methanol production. New Zealand methanol is the swing producer in the region so its closure would immediately be felt and other participants would be able to seize the opportunity to fill the supply gap.
18. Industrial allocation will remain important as domestic carbon prices increase to avoid premature closure of firms.
19. In terms of skills transfer, it is important that existing skills in the energy resources sector are not prematurely ended through the effects of government regulations before new jobs are available in alternate firms and sectors. If a 'gap'

emerges, this is negative not only for workers out of between employment but also for firms in low emissions sectors.

20. The skills in the petroleum sector will have a critical role in supporting other industries such as geothermal, hydrogen or biogas. These skills can also support increased importation of refined petroleum products if the remaining refineries in Australia and at Marsden Point close in the near term. A vibrant ecosystem of service providers is vital both to the current sector but also to the transference of skills and capabilities to adjacent sectors. If such firms cannot access skills then they will struggle to profitably operate.

### **Amendments to unit limit auction price control settings**

21. We do not support the proposal to remove 27 million units from the volume to be auctioned (2021-2025). We consider this level of regulated reduction in the stockpile is too high. It is important to recognise that these stockpile units holders may not even enter the market (in which case the units will obviously not be used).
22. Removal of units deemed as surplus should not occur until greater depth and liquidity is realised in the carbon market especially since the regime is only now subject to a cap and time is needed for the effects of that to bed in.

### **Amendments to auction price control settings and the cost containment reserve**

23. We agree in principle that a pricing corridor or window must be sufficiently wide to enable price discovery by the market. However, we do not consider that government should be regularly tinkering with the regime and its parameters. Time is needed for the regime to bed in.
24. If the ETS is to be a genuine market-based instrument then actors need to be able to operate within its confines without having to constantly anticipate the next regulatory change.
25. It is important to recognise that policy changes to the ETS can lead to price volatility (at least in the short run) as participants respond to changes, either real or anticipated. Policy changes can also lead to long run increases in the price, and at a certain point (specific to firms) this may begin to compromise profitability and competitiveness so care must be exercised.
26. We oppose both:
  - increasing the price floor from \$20 to \$30; and
  - increasing Cost Containment Reserve (CCR) from \$50 to \$70 and subsequently by 5% plus 2% inflation per annum.
27. Having new statutory parameters relating to price risks becoming self-fulfilling in terms of high upward pressure on prices (especially under a capped regime). Changing the parameters may be seen to signal where Government wants carbon pricing to head, and the mere fact of doing this may mean participants rely on such changes rather than the genuine interaction of supply and demand.
28. It appears that the CCR price may be being increased to avoid it being triggered. The CCR should be in place to protect New Zealand firms and individuals from

the impacts of price spikes or sustained high prices beyond the ability of firms to reasonably abate without having to close down.

29. In terms of the idea of prescribing specific and regular price increases, we oppose this in principle. Regulated price increases should only ever be done on a case by case basis when specific circumstances demonstrably warrant this. A 'set and forget' approach is unwarranted and is akin to having automatic tax hikes set in advance regardless of the circumstances. We note that a 5% per annum increase doubles the carbon price every 14.4 years.

### **Default emission factors**

30. We support updating the default emission factors for natural gas using emission return data. This will increase the accuracy of the default emission factors, reduce the potential for inconsistencies between gas producers (using unique emission factors) and opt-in customers (using default emission factors), and ensure emission data is accurate.

### **International units**

31. We agree that "Article 6 of the Paris Agreement provides the framework for the way countries can co-operate to reduce emissions and increase climate change actions". Advancing bilateral or multilateral arrangements for international trading will be important and the Government should advance this work.
32. Our view is that a fundamental reason to use an Emissions Trading Scheme, (compared to a carbon tax) is that it enables international trading to achieve emission reductions at the lowest marginal cost. To realise that goal, it is essential that international units can be used (although clearly they must be genuine and of high integrity). Without international trading, New Zealand is not utilising the full benefits of an ETS.
33. International units are a legitimate and important mitigation option especially to avoid unreasonable domestic costs and impacts on firms. As discussions relating to Article 6 of the Paris Agreement and/or bilateral or multilateral agreements advance we trust that New Zealand will be able to take advantage of offshore mitigation.
34. Access to international units is especially important given legislation requires that units released under the CCR are eventually backed by real units. In the situation that the CCR is triggered it is likely that affordable domestic abatement will be hard to come by, which means offshore mitigation is likely to be the most affordable option. Having a regime in place to access such units will therefore be important.
35. International units are also important so that emitters have an alternative source of units should foresters seek to deliberately hold back the supply of units to increase their price.
36. Ultimately we recognise the sovereign right of the New Zealand Government to choose domestic policies, but it seems unusual to actively contribute to

advancing Article 6 while at the same time all but rule out the domestic use of offshore units.

37. In considering access to international units, it is also important to recognise the mutually beneficial nature of trade. If the New Zealand Government or firms purchase units from offshore, there is a finance transfer meaning that the counterparty can use that money for domestic decarbonisation.

### Providing for carbon capture and storage

38. In reviewing the ETS, it would be desirable for officials to consider the current barriers to carbon capture and storage (“CCS”) caused by specific ETS rules.
39. CCS is a ‘removal activity’ under the Climate Change Response Act. That means the removing entity (i.e. an operator of a suitable geological formation) could receive one ETS credit for every tonne of CO<sub>2</sub> removed and stored.
40. However, that only applies where the capture and storage is related to a given operator’s activities. So, if an operator were to store carbon on behalf of a third party, then that operator could not currently claim ETS credits.
41. The framework should be amended so that an entity performing CCS can receive ETS credits, regardless of whether or not that entity was the source of the CO<sub>2</sub>. This issue and other barriers to CCS are covered in detail in *Carbon Capture and Storage: Designing the Legal and Regulatory Framework for New Zealand*<sup>3</sup>.

### Appendix: Answers to specific questions

In addition to making general points, our submission responds to proposals in Section 1.2 *Update auction price control settings* and section 2.2 *Update the DEFs for natural gas* of the consultation document. References to paragraphs that relate to specific questions are made below. We have not answered questions in other sections.

<b>Questions in Section 1.2 <i>Update auction price control settings</i></b>	
Question 6. Do you agree that the options outlined are the correct options to consider? If not, why not? Do you have any further options to suggest?	n/a
Question 7. What are your views on increasing the NZU auction price floor to \$30 from 1 January 2022, in line with the Commission’s draft recommendation?	See para 22-28 of the main submission.
Question 8. How would a higher price floor affect you?	See Para 26
Question 9. What are your views on increasing the auction price floor by 5 per cent plus 2 per cent inflation per annum, in line with the Commission’s	See para 22-28 of the main submission.

<sup>3</sup>[https://www.waikato.ac.nz/\\_data/assets/pdf\\_file/0011/179570/University-of-Waikato-CCS-Report-2013-web.pdf](https://www.waikato.ac.nz/_data/assets/pdf_file/0011/179570/University-of-Waikato-CCS-Report-2013-web.pdf)

draft recommendation? If you don't agree, what are your reasons?	
Question 10. What are your views on increasing the cost containment reserve (CCR) to \$70 from 1 January 2022, in line with the Commission's draft recommendation? If you don't agree, what are your reasons?	See para 22-28 of the main submission.
Question 11. What are your views on increasing the CCR by 10 per cent plus 2 per cent inflation per year, in line with the Commission's draft recommendation? If you don't agree, what are your reasons?	See para 22-28 of the main submission.
Question 12. What are your views on updating CCR volumes, as shown in table 10?	n/a
<b>Questions in section 2.2 <i>Update the DEFs for natural gas</i></b>	
Question 15. To what extent do you agree with the way we have described the issue? Do you have any further options to suggest?	n/a
Question 16. Would you prefer the DEFs to be updated, or for the current DEFs to remain unchanged?	See para 30 of the main submission
Question 17. Has the natural gas class you use NOT been updated?	n/a
Question 18. Are any of the existing classes now redundant?	n/a