



# Draft Cabinet Paper: Approval to consult on the annual update to New Zealand Emissions Trading Scheme unit limit and price control settings

Date Submitted:	29 July 2022	Tracking #: BRF-1854	
Security Level	Policy and Privacy In-Confidence	MfE Priority:	Urgent

	Action sought:	Response by:
Hon James SHAW, Minister of Climate Change	<p><b>Provide</b> feedback on the attached documents</p> <p><b>Meet</b> with officials to discuss your feedback and next steps in the process</p> <p><b>Note</b> that prior to lodging, the consultation document will be formatted and edited to the required standard for publication</p>	Monday 1 August

Actions for Minister's Office Staff	<b>Return</b> the signed report to MfE.
Number of appendices and attachments #3	<ol style="list-style-type: none"> <li>1. Draft Cabinet paper: <i>Approval to consult on the annual update to New Zealand Emissions Trading Scheme limit and price control settings for units</i></li> <li>2. Draft consultation document: <i>Proposed changes to New Zealand Emissions Trading Scheme limit and price control settings for units</i></li> <li>3. Requirements for regulations</li> </ol>

## Key contacts

Position	Name	Cell phone	1st contact
Principal Author	Dave Hodson		
Responsible Manager	Kate Whitwell	022 137 5939	✓
Director	Hemi Smiler		


# Draft Cabinet Paper: Approval to consult on the annual update to New Zealand Emissions Trading Scheme limit and price control settings for units

## Key Messages

1. This briefing seeks your feedback on the draft Cabinet paper *Approval to consult on the annual update to New Zealand Emissions Trading Scheme limit and price control settings for units* (Attachment 1) and draft consultation document *Proposed changes to New Zealand Emissions Trading Scheme limit and price control settings for units* (Attachment 2).
2. Advice was received from the Climate Change Commission (the Commission) on updates to these NZ ETS unit settings. The Cabinet paper seeks approval to consult on and release the attached consultation document, which considers updates to these settings. It also seeks approval for you to make minor editorial changes to the consultation document up until its release.
3. Your feedback is required now so the Cabinet paper and consultation document can be lodged by 17 August 2022 for consideration at the Cabinet Economic Development Committee (DEV) on 24 August.
4. Timeframes remain tight, and decisions will need to be made quickly to ensure that amendments to regulations are made by 31 December.

## Recommendations

We recommend that you:


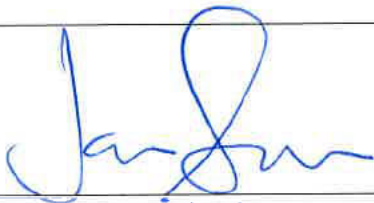
- a. **Note** that the draft consultation document and Cabinet paper reflect the Commission's advice among the presented options
- b. 
- c. **Note** the draft Cabinet paper and consultation document have been circulated to agencies and that feedback is expected early next week
- d. **Provide** feedback on the draft Cabinet paper and consultation document by 1 August

Yes/No

- e. **Note** that prior to lodging, the consultation document will be formatted and edited to the required standard for publication
- f. **Meet** with officials for further discussion on 1 August

Yes/No

## Signature

Hemi Smiler Director Climate Change Directorate	
Hon James SHAW, Minister of Climate Change	
Date	30/7/22

## Purpose

5. This briefing seeks your feedback on the draft Cabinet paper *Approval to consult on the annual update to New Zealand Emissions Trading Scheme limit and price control settings for units* (Attachment 1) and draft consultation document *Proposed changes to New Zealand Emissions Trading Scheme limit and price control settings for units* (Attachment 2).

## Context

6. Limits for units describe the volume of new NZUs the Government can provide to the market annually, other than units transferred for removal activities, which are unlimited. Price control settings provide the government with a mechanism to help manage unacceptably low or high prices in the NZ ETS.
7. Updates to unit setting regulations are required annually to ensure that, at all times, they cover each of the next five calendar years. This requires amendment regulations that must be made this year for the period 2023-2027. The Climate Change Commission (the Commission) provided advice on these settings, and this advice must be considered when making these updates.
8. This is the second year that these settings will be updated since they were prescribed in regulations in 2020. The first regulations for NZ ETS unit settings entered into force in January 2021, in time for the introduction of NZ ETS auctions. These unit settings were updated in 2021, with effect from 1 January 2022, to directly reflect advice from the Commission on these settings.
9. Now that the emissions budgets are set, the Commission is required to give formal recommendations on these unit settings on an annual basis. The Commission's advice is one of the matters that must be considered as part of updating these settings. A report containing these recommendations was provided late on Friday 15 July, and published on Wednesday 27 July.

## Analysis and advice

10. The Commission's advice included extensive commentary on matters related to the NZ ETS and how they could influence NZ ETS unit settings in future. This commentary is distinct from decisions required this year, and this is made clear in the attached Cabinet paper and consultation document.
11. We briefed you on the content of the Commission's advice on 15 July [BRF-1853 *Climate Change Commission Advice on NZ ETS Limit and Price Control Settings for Units*], and discussed the advice with you on Monday 18 July. You indicated your initial thoughts on the Commission's recommendations, and requested that we include mention of the overlap between the update to NZ ETS unit settings and other work programmes. This is included in the draft Cabinet paper.

### *Summary of Commission recommendations*

12. The Commission's recommended settings differ significantly from current settings and include much higher and wider auction price control settings for units.

*New approaches to calculating auction volumes*

13. The Commission has included new technical adjustments and updated stockpile adjustment approaches in calculating auction volumes, limits for units, and volume of the cost containment reserve.
14. These recommended approaches are included in the discussion document, and compared with the approach taken previously. The impact of the proposed stockpile reduction approach on liquidity, price discovery, and an effective secondary market for NZUs is something we look to get feedback on as part of consultation.

*The Commission has considered gross emissions reductions as the key input to its advice on price settings*

15. In arriving at new recommendations for price control settings, the Commission considers gross emissions reductions in its advice. To do this, the Commission established a target level of gross NZ ETS emissions. This is based on its demonstration path and aligns with the sector sub-targets described in Table 1.2 of the emissions reduction plan (ERP).
16. The Commission then tested for the emissions price path required to meet this overall target level under the different scenarios we created to reflect the baseline and policy uncertainty. This allowed for under- or over-achievement of the sector sub-targets so long as total NZ ETS emissions meet the target level.
17. The Commission describes this in their advice as:

*"... testing uncertainty around the emissions prices needed to deliver the intended gross emissions reductions for NZ ETS sectors"*

18. s 9(2)(g)(i)

s 9(2)(g)(i)

19. If the Commission had provided price control settings recommendations in reference to legislated targets, the prices recommended would have been significantly lower. In Ināia tonu nei, the Commission stated that meeting the 2050 target will involve marginal abatement costs that are higher than current NZ ETS auction price control settings, at around \$140 in 2030. In its latest advice, the Commission indicates that this conclusion remains unchanged.
20. If any changes are made in the future to NZ ETS supply settings that result in unequal treatment of gross and net emissions reductions it would be appropriate to update NZ ETS unit settings to reflect such changes. Updating unit settings now with reference to gross emissions reductions is pre-empting decisions that have not yet been made, and does not reflect requirements in legislation. The consultation includes options that are based on the current net-settings and closely reflect current price controls.



*The Commission has considered impacts from its recommendations, and deemed them out of scope*

21. Impacts on households and the economy are required to be considered as part of making recommendations on price control settings. Emissions pricing has a direct impact on energy prices, household costs, and the ongoing viability of emissions-intensive trade-exposed firms.
22. The primary intended purpose of price control settings is to help manage unacceptably low or high prices in the NZ ETS. What determines acceptability is the level, scale, and types of impacts that these prices cause, including on the ability to meet emissions budgets and targets.
23. The Commission has presented a contrary view. The Commission has, as required, considered the impact of prices on households and the economy. Having considered these impacts, as well as the nature of the NZ ETS as a market mechanism, its view is that these impacts should not be a primary determinant for the NZ ETS price control settings.
24. The Commission states that:  
*"In the absence of complementary policies, higher emissions prices will result in disproportionate impacts on lower income households and those least able to adjust. The NZ ETS price control settings are not the appropriate tool for addressing domestic distributional impacts or other equity considerations in the transition. These distributional impacts can be best managed if the Government puts in place targeted policies alongside the NZ ETS to support those most disadvantaged and those least able to adjust."*
25. Although price controls aren't the place to address household and economic impacts of higher prices, they are the place to limit these impacts occurring. This is achieved by setting automatic mechanisms to dampen prices if they reach unacceptably high levels. The Commission does not consider it appropriate to use price controls to prevent these impacts, s 9(2)(g)(i).

*Feedback is being sought on these issues, and others, as part of the consultation process*

26. The Cabinet paper highlights that there are some elements of the advice from the Commission that are out-of-scope, and other elements that require careful consideration.
27. Further input from agencies next week is expected to better describe these issues in both the Cabinet paper and the consultation document. We hope to be able to largely address this feedback prior to ministerial consultation, while noting that further feedback may come in during this period.
28. The consultation document also seeks feedback on these elements of the Commission's advice.
29. As noted above, you must be satisfied the limits and price control settings are in accordance with the budget and NDC applying to 2023-2027, and the 2050 target. However, they need not strictly accord if you are satisfied the discrepancy is justified, after considering the other matters required to be considered.
30. These other matters include the impact of emissions prices and households and the economy (when setting the price control settings) as discussed in more detail above. You must also consider the matters set out in Attachment 3 to this briefing. Detail on consideration of these matters will be provided as part of the consultation report-back.

There is also reference to these matters in the assessment of options in the attached draft consultation paper.

31. In addition, under s 5ZN the emissions reduction plan and emissions budgets for future periods can also be considered when making these decisions. Further advice on these matters will be provided to you following consultation.

## Other considerations

### *Consultation and collaboration*

32. The drafts of the consultation document and Cabinet paper were circulated for agency feedback on Thursday 28 July.
33. Feedback from agencies is expected early next week. We have had an initial conversation on the Commission's advice and other matters that must be considered with officials from the Treasury, Ministry for Primary Industries, Ministry for Business, Innovation and Employment, and the Department of Prime Minister and Cabinet.

### *Risks and mitigations*

34. There are significant timing risks associated with delivering the regulation updates this year. We have briefed you on this previously [BRF-1408: *Annual update to NZ ETS Unit Supply and Price Control settings - timing considerations*]. This risk can be partially mitigated by notifying the consultation through appropriate channels, providing clear information to support understanding of the proposals, and actively seeking the views of significant stakeholders before and during the consultation period. The Ministry will provide further advice setting out a consultation plan to assist in meeting these requirements.
35. Feedback during ministerial and agency consultation could further affect delivery timeframes.

### *Legal issues*

36. s 9(2)(h)

37. s 9(2)(h)

### *Financial, regulatory and legislative implications*

38. There are no financial, regulatory and legislative implications associated with the proposals in this briefing note. Regulatory amendments will be required to implement the proposals. Drafting approval for these will be sought at the time of policy decisions in

October 2022. The Climate Change (Auctions, Limits, and Price Controls for Units) Regulations 2022 will need to be amended to update the prescribed unit settings. Financial implications of any updates proposed will be provided in the post-consultation report back Cabinet paper seeking policy decisions.

## Next steps

39. Indicative timelines are provided in the table below. These will be fluid through this process. Decisions will need to be made quickly to enable the legislative deadline to be met.

**Table 1: Indicative timelines for this work**

Ministerial consultation	3-16 August
Paper considered at DEV	24 August
Public consultation	30 August-27 September
Draft policy decisions Cabinet paper to Minister	13 October
Ministerial consultation	17-26 October
Policy decisions considered at ENV	10 November
PCO drafting, draft LEG paper to Minister	17 November
Ministerial consultation (5 days)	22-29 November
Paper considered at LEG	8 December



## **Attachment 1: Draft Cabinet paper: Approval to consult on the annual update to New Zealand Emissions Trading Scheme limit and price control settings for units**

Early draft withheld s 9(2)(g)(i). Later draft released Appendix to document 5: BRF-1996. Final version released as document 6: CAB-155

## **Attachment 2: Draft consultation document: *Proposed changes to New Zealand Emissions Trading Scheme limit and price control settings for units***

Early draft withheld s 9(2)(g)(i). Later draft provided as Appendix to document 5: BRF-1996. Final versions publicly available s 18(d).

<https://environment.govt.nz/publications/proposed-changes-to-new-zealand-emissions-trading-scheme-limit-and-price-control-settings-for-units-2022-consultation-document/>

## Attachment 3: Requirements for regulations

### Climate Change Response Act 2002, section 30GC Requirements for regulations about limits and price control settings for units (excerpt)

- (2) The Minister must be satisfied that the limits and price control settings are in accordance with—
  - (a) the emissions budget, and the nationally determined contribution for New Zealand under the Paris Agreement, that applies to—
    - (i) the period for which the limits or price control settings are being prescribed; or
    - (ii) any period after that, if a budget or contribution exists for that period; and
  - (b) the 2050 target.
- (3) However, they need not strictly accord with the budgets or contributions as long as the Minister is satisfied that the discrepancy is justified, after considering the other matters under this section.
- (4) The Minister must consider—
  - (a) the main matters; and
  - (b) the additional matters, but only in relation to the price control settings.
- (5) The main matters are as follows:
  - (a) the projected trends for New Zealand's greenhouse gas emissions in the 5 years after the current year, including—
    - (i) the anticipated volumes of greenhouse gas emissions to which the emissions trading scheme applies (meaning emissions for which participants are required to submit returns or surrender units under this Act); and
    - (ii) the anticipated volumes of greenhouse gas emissions to which the emissions trading scheme does not apply;
  - (b) the proper functioning of the emissions trading scheme;
  - (c) international climate change obligations and instruments or contracts that New Zealand has with other jurisdictions to access emissions reductions in their carbon markets;
  - (d) the forecast availability and cost of ways to reduce greenhouse gas emissions that may be needed for New Zealand to meet its targets for the reduction of emissions;
  - (e) the recommendations made by the Climate Change Commission under section 5ZOA;
  - (f) any other matters that the Minister considers relevant.
- (6) The additional matters are as follows:
  - (a) the impact of emissions prices on households and the economy;
  - (b) the level and trajectory of international emissions prices (including price controls in linked markets);
  - (c) inflation.

**Appendix: Discussion document - *Proposed changes to New Zealand Emissions Trading Scheme Limit and Price Control Settings for Units 2022***

Publicly available