

s 9(2)(a)

Newsroom

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Dear s 9(2)(a)

On 12 September 2018, you emailed the Office of the Minister of Transport Hon Phil Twyford requesting various documents under the Official Information Act 1982 (the Act). On 17 September 2018, the following part of that request was transferred to the Ministry for the Environment:

13/07/2018 Improvements to the NZ Emissions Trading Scheme MFE

We are releasing the document to you in part and it is enclosed, with redactions made under s 9(2)(f)(iv) of the Act in order to maintain the confidentiality of advice tendered by Ministers.

You have the right to seek an investigation and review by the Ombudsman of this decision. Information about how to make a complaint is available at www.ombudsman.parliament.nz or freephone 0800 802 602.

If you have any queries, please feel free to contact our Executive Relations team.

Sincerely


Roger Lincoln
Director, Climate Change

*Improvements to the NZ Emissions
Trading Scheme*

Draft as at 11 July 2018

COMMERCIALY SENSITIVE

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Context

- A number of improvements are being proposed to the NZ Emissions Trading Scheme (NZ ETS).
- A review of the scheme in 2015/16 found that it had failed to drive emissions reductions and was in need of reform.
- The NZ ETS puts a price on greenhouse gas emissions and covers all emissions except agriculture. The current carbon price is \$21.80.
- ENV will consider two papers on 31 July - one on improvements to the overall ETS framework and one specifically on forestry settings.
- Consultation on the proposed changes to the NZ ETS are timed to follow consultation on the Zero Carbon Bill.
- The NZ ETS is the Government's primary tool to reduce emissions, and will play a central role in a just transition to a low emissions economy.

NZ Emissions Trading Scheme Review

- A review of the NZ ETS was initiated in response to the new Paris Agreement on Climate Change in 2015/16.
- The review of the found the NZ ETS does not have the tools to effectively meet our 2030 target (or future climate change targets under the Zero Carbon Bill).
- In response to this, four in-principle Cabinet decisions were taken by the previous Government to:
 - a) introduce auctioning of units, to align the supply of units in the NZ ETS to our climate change targets
 - b) limit participants' use of international units if the NZ ETS were to reopen to international carbon markets
 - c) develop a different price ceiling to eventually replace the current \$25 fixed price option
 - d) coordinate decisions on the supply settings in the NZ ETS over a rolling five-year period.
- Taken together these decisions form the basis of a 'cap' on emissions.

Proposals for consultation

- A package of changes are now being proposed for the NZ ETS. These changes will improve the overall credibility, integrity and operation of the scheme.
- The proposals cover the following issues:
 1. **How the supply of units is managed in the scheme:** these changes focus on improving the overall framework of the NZ ETS and implementing the in-principal decisions taken in 2017.
 2. **Improvements to forestry:** these changes aim to improve incentives for forestry and the operation of the scheme for forestry participants.
 3. **Strengthening market integrity:** these changes aim to improve the information available to ETS participants and how risks are managed in the NZ carbon market.
 4. **Operational improvements:** these changes focus on improvements to the compliance and penalties regime, as well as other operational changes.

Issues not being consulted on now

- The proposals for consultation do not include:
 - **Whether or not to include agriculture in the NZ ETS** – a decision on agriculture will follow advice from the Climate Change Commission in 2019
 - **The specific settings of the NZ ETS** – this includes:
 - the level of the new price ceiling and associated reserve auction volume
 - the amount of units to be auctioned
 - or the level of the limit on international units.

These decisions will need to be made following the outcome of the ZCB process.

Summary of proposals for consultation

- 1 Auctioning
- 2 Price ceiling
- 3 Decision-making process
- 4 Free allocation
- 5 Importing international units

Unit supply workstreams (MfE lead)
These workstreams have strong inter-dependencies with decisions made about the ZCB and our 2030 target.

- 6 Market information
- 7 Governance

Market integrity workstreams (MfE lead)

- 8 Forestry (domestic accounting)
- 9 Forestry (operational)
- 10 Permanent forests

Forestry workstreams (MPI lead)

- 11 Penalties and compliance

Compliance workstream (EPA lead)

Framework vs settings

Step 1: policy framework

- How are decisions made about the supply of units and cap on emissions?
- If we decide to use them, how would we import international units and limit their volume?
- How will our new price ceiling mechanism work?
- What type of auction should be used?

The current NZ ETS proposals are focussed on putting in place the right framework in legislation

Step 2: policy settings

- Do we want to use international units, and if so how many do we want to use and where would they come from?
- What do we want to set the NZ ETS price ceiling at?
- How many units will be auctioned?

ETS settings decisions are linked to questions about the role of the Climate Commission and the level of domestic ambition in meeting our 2030 target. ETS settings are proposed to be implemented through regulations developed in early 2019

Appendix

NZ ETS proposals

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Decision-making

Issue	The NZ ETS currently lacks a predictable framework for announcing future supply volumes, which undermines the scheme's effectiveness
Proposal	To coordinate all unit supply settings on a five-year rolling basis, which is extended by a year on an annual basis
Stakeholder views	This proposal addresses the issue of how decisions are made about the NZ ETS, which was the most significant concern raised by stakeholders during the ETS review. We expect discussion to focus on the role of the Commission may take in ETS decision-making

Auctioning

Issue	An auctioning mechanism is necessary to ensure that the supply of units into the NZ ETS is aligned with our climate change targets
Proposal	To auction New Zealand Units (NZUs) using a single round, sealed bid, uniform price auctioning format
Stakeholder views	We expect feedback on auctioning to be technical in nature.

Price ceiling

Issue	The current Fixed Price Option (FPO) creates fiscal risk for the government because there is no volume limit on its use. The level that it is currently set at (\$25) does not provide for prices to rise to levels that are expected in the 2020s.
Proposal	Replace the FPO with a new price ceiling mechanism called a cost containment reserve. This will result in NZUs being auctioned when prices reach a trigger level.
Stakeholder views	Stakeholders will be interested in a move away from the FPO, but this has been well signalled. The level of the price ceiling is set in regulations later on is likely to be an important issue for many ETS participants.

Industrial allocation

Issue	If the current settings for industrial allocation remain, the government is likely to be issuing more free allocation than necessary to mitigate the risk of emissions leakage and be unable to meet future carbon budgets
Proposal	To implement a different decision-making process for industrial allocation (which might include advice from the CCC) and seek feedback on the impact of a phase-down of industrial allocation on businesses at a rate of 1-3%
Stakeholder views	Industrial allocation is sensitive for many large firms

Importing international units

Issue	A framework is needed so that international units can be imported into the NZ ETS if/when they are needed
Proposal	To either allow NZ ETS participants to be the buyers of international units, or for the NZ government to play this role
Stakeholder views	The method of import is a technical issue, and we expect stakeholders to express a preference for direct purchasing. The level of the international limit set in regulations later on will be of strong interest to ETS participants.

Market information

Issue	Improvements can be made in how easy it is to get access to NZ ETS information and data
Proposal	To develop a website that provides a central portal through which government data about the scheme can be obtained
Stakeholder views	We expect feedback to be technical in nature

Governance

Issue	Areas have been identified with potential risks for NZ ETS participants when trading with each other
Proposal	Either to apply existing financial market regulation to trading within the NZ ETS, or to build a tailor-made regulatory regime
Stakeholder views	We expect interest from market intermediaries and forestry consultants on this topic, as any change may increase costs to comply with new rules.

Forestry (domestic accounting)

Issue	Current ETS accounting for forest carbon is risky, complex and will be misaligned with how we account for our 2030 target
Proposal	Introduce an 'averaging' approach for newly established forests to increase NZ ETS incentive for new forests and seek views on accounting options for existing forests
Stakeholder views	Proposals are technical in nature but there will be a high degree of stakeholder interest, particularly about options for existing forest owners. The forestry sector are likely to be comfortable with a move to averaging for new forests.

Forestry (operational)

Issue	The ETS review and day to day operation of the NZ ETS have identified a range of operational and technical issues for forestry which make the ETS unattractive to take part in
Proposal	Set of 26 improvements to the operations of the NZ ETS for forestry participants and the Crown, that require legislative change
Stakeholder views	Likely to be of a technical nature and generally supportive.

Permanent forests

Issue	The options for permanent forests to earn NZUs are not providing enough incentive to encourage establishment of new forests.
Proposal	To introduce a permanent post-1989 forest activity into the ETS, and disestablish the current policy (Permanent Forest Sink Initiative), which has only 60 participants.
Stakeholder views	Based on two prior consultations the new ETS activity is likely to be widely supported, but we expect a difference of opinion around design details (which we are consulting on)

Penalties and compliance

Issue	Current set of compliance tools have proven to be administratively cumbersome and possibly ineffective, particularly for low-level offending
Proposal	Use infringement regime (instant fines) instead of warnings or prosecutions for low level offences and feedback on whether to update the emissions unit penalty.
Stakeholder views	We expect most feedback from forestry sector, where most non-compliance is occurring

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