



Briefing: NZ ETS and the final ERP2

Date submitted: 12 September 2024

Tracking number: BRF-5253

Sub Security level: Classification

MfE priority: Urgent

Actions sought from Ministers		
Name and position	Action sought	Response by
To Hon Simon WATTS Minister of Climate Change	Provide feedback on the draft NZ ETS chapter for ERP2.	18 September

Actions for Minister's office staff
Return the signed briefing to the Ministry for the Environment (ministerials@mfe.govt.nz).

Appendices and attachments
1. Strengthening the New Zealand Emissions Trading Scheme

Key contacts at Ministry for the Environment			
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Minister's comments

NZ ETS and the final ERP2

Key messages

The NZ ETS chapter for the final ERP2

1. Officials are seeking your feedback on the draft “Strengthening the New Zealand Emissions Trading Scheme” chapter for the second emissions reduction plan (ERP2) in **Appendix 1**.
2. We recommend the NZ ETS content in the final ERP2 further clarifies the role the NZ ETS will play in achieving the second emissions budget, future emissions budgets and climate change targets. Although the Government does not have a preferred NZ ETS price path, more detail could be included on the modelled NZ ETS price pathway and the contribution the NZ ETS is expected to make towards achieving EB2.
3. Officials propose the final chapter also provides further detail, where possible, on the other areas flagged as key actions to strengthen the NZ ETS in the discussion document. These include:
 - a. How the Government will continue to monitor the risk posed by the stockpile and respond accordingly as part of future NZ ETS settings decisions to support a credible risk management strategy.
 - b. [NZ ETS cap work?]
 - c. The work underway and next steps for strengthening NZ ETS market governance and assurance.
 - d. [Next steps on the industrial allocation work programme.]
 - e. The key policy decisions Government has taken and next steps to limit whole farm conversions to exotic forestry on high- and medium-quality land from registering in the NZ ETS to manage impacts of the NZ ETS.
4. The appended draft NZ ETS chapter includes the further detail recommended above, in order to give you a sense of how the chapter would read if these points were incorporated. We will provide you with a draft of the final ERP2 in early October.
5. You will also receive separate advice on the Government’s broad approach to ERP2 in the coming weeks. [Placeholder for reference to upcoming advice on sufficiency]
6. The initial review of submissions suggests overall support for the Government’s approach to strengthening the NZ ETS. The feedback aligns with the proposed changes to the chapter outlined above.
7. We received feedback from businesses, iwi/Māori, climate experts, NZ ETS participants, NGOs and the wider public.
8. Although the analysis of the ERP2 submissions is still ongoing, we have identified a number of themes from submissions made by a range of key NZ ETS stakeholders, covering views on how to achieve or support NZ ETS market credibility, how to improve

the ability of the NZ ETS to be the key tool, and what needs to happen to see significant decarbonisation

9. We will provide you with a comprehensive summary and analysis of submissions on ERP2 in the coming weeks.

Recommendations

We recommend that you:

Clarify the role of the NZ ETS

- a. **Agree** to include further information in the final ERP2 to further clarify:

i	the role the NZ ETS will play in achieving the second emissions budget and future emissions budgets and climate change targets	Yes / No
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Options to support NZ ETS market credibility and confidence

- b. **Agree** to include further information, where possible, in the final ERP2 on:

i	NZ ETS settings decisions for 2025-29, including managing the stockpile	Yes / No
ii	How the Government will continue to monitor the risk posed by the stockpile and respond accordingly as part of future NZ ETS settings decisions to support a credible risk management strategy.	Yes / No
iii	Work to strengthen market governance and assurance, and when further information will be made publicly available	Yes / No
iv	[Next steps for industrial allocation]	Yes / No
v	Further detail on limiting whole farm conversions to exotic forestry on high- and medium-quality land from registering in the NZ ETS	Yes / No

- c. **Note** that the appended draft NZ ETS chapter includes the detail recommended above, in order to give you a sense of how the chapter would read if these points were incorporated.

Next steps

- d. **Provide feedback** on the draft NZ ETS chapter of the final ERP2.

Signatures

Mark Vink
General Manager

Markets

X September 2024

Hon Simon WATTS
Minister of Climate Change

Date

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NZ ETS and the final ERP2

Purpose

1. This briefing provides you with some key themes from NZ ETS stakeholder submissions on the ERP2 and seeks your direction and feedback on the draft NZ ETS chapter for the final ERP2.

Context

2. The NZ ETS is the Government's key tool to help meet the second emissions budget, future emissions budgets and climate change targets. This supports the Government's proposed net-based and market-led approach to meeting New Zealand's climate change targets.
3. Consultation on the ERP2 took place from 17 July until 25 August. We received over 1800 submissions, held over 40 consultation events, two of which were NZ ETS webinars. Over 350 submitters provided feedback on the NZ ETS. There were 76 submitters who identified as NZ ETS participants.

The NZ ETS chapter for the final ERP2

4. The NZ ETS chapter of the ERP2 discussion document identified that the Government has made two key commitments and is progressing actions to support market credibility and confidence. It also pointed to the Government ending the ETS review upon taking office in 2023.
5. Actions to support a credible NZ ETS and broader market confidence included: (1) progressing annual ETS settings decisions, (2) exploring options to strengthen market governance and assurance, (3) progressing updates to industrial allocation, and (4) managing impacts of the NZ ETS by restricting entry of new exotic forests into the NZ ETS on productive farmland.
6. Since the ERP2 discussion document was published, the Government has made decisions, and we propose you provide further detail on the policy actions for the final ERP2, as outlined below.

Including key NZ ETS settings decisions

7. The Government has recently made a significant decision on the NZ ETS settings for 2025-2029, including managing the stockpile. This has been received positively as evidence of the Government's commitment to a market-led approach to meeting New Zealand's budgets and targets. Including these key decisions will provide more substance to the NZ ETS chapter.

Clarifying the role of the NZ ETS in achieving budgets and targets

8. Officials recommend ERP2 further clarifies the role the NZ ETS will play in achieving the second emissions budget, future emissions budgets and climate change targets. Although the Government does not have a preferred NZ ETS price path, more detail could be included in the chapter on the modelled NZ ETS price pathway and the contribution the NZ ETS is expected to make towards achieving EB2.
9. Officials will provide you with advice on the sufficiency of the proposed ERP2 for EB2 in the coming weeks [BRF-xxxx refers].
10. The role the NZ ETS will play in delivering New Zealand's current and future Nationally Determined Contributions (NDCs) is likely to be subject of further Cabinet consideration, particularly as part of setting NDC2. We, therefore, do not recommend including this point in the final ERP2 to allow space for further Cabinet consideration.

The NZ ETS cap

11. Defining how much of the emissions budgets will be covered by the NZ ETS (the NZ ETS cap) is a necessary step in determining NZ ETS settings. Projected industrial allocation, desired surplus stockpile reduction, and technical adjustments are subtracted from the NZ ETS cap to determine the remaining volume of NZUs that can be auctioned. Price controls, notably the auction price floor, are also set based on the NZ ETS cap.
12. This year's NZ ETS settings decisions were based on an NZ ETS cap linked to sector sub-targets from the first emissions reduction plan. This is because this spilt aligns with interim projections conducted for ERP2 consultation, and the Government's strategy and directions. The publication of ERP2 provides an opportunity for the Government to signal its preferred approach to determining the NZ ETS cap for future NZ ETS settings decisions.
13. Providing this clarity is likely to support NZ ETS market credibility and confidence by helping inform NZ ETS participants' expectations about the future (ie how many NZUs will be made available for auction and at what prices). It will also help inform the Commission's advice on NZ ETS settings and official's parallel policy work.
14. Officials expect to brief you on options to inform future decisions in the coming weeks [BRF-xxxx refers]. We will reflect your direction on this advice in further iterations of the NZ ETS chapter for the final ERP2.

How else to support a credible NZ ETS market and broader market confidence

15. We recommend the NZ ETS chapter for the final ERP2 further provides updates and more clarity to the market as well as wider public in the following areas.

Future NZ ETS settings decisions

16. The draft NZ ETS chapter highlights that the Government's latest NZ ETS decisions aim to eliminate the surplus portion of the stockpile by 2030, assuming net emissions from NZ ETS sectors are as high as (or higher than) expected. It also highlights that the Government will continue to monitor the risk posed by the stockpile and respond accordingly as part of an adaptive management approach and to support a credible risk management strategy.

Strengthening market governance and assurance

17. The ERP2 discussion document highlighted work underway to strengthen market governance, to improve the transparency of market information and the integrity of the market, and to enhance participants' understanding of how the market works.
18. You recently indicated to officials your preference for engagement and timing for seeking Cabinet agreement related to work on market governance [BRF-5142 refers]. Subject to your direction, we can update the NZ ETS chapter informed by how this work progresses.


Industrial allocation

19. The ERP2 discussion document highlighted work underway to update industrial allocation settings. Subject to your direction, we can update the NZ ETS chapter informed by upcoming decisions to update the industrial allocation regulations.
20. You may wish to consider if any further work in the longer term on industrial allocation such as increasing the phase out or considering alternatives should also be identified and committed to.


Managing impacts of the NZ ETS

21. The ERP2 discussion document acknowledges the NZ ETS creates incentives that could result in large-scale exotic afforestation on productive farmland and whole-farm conversions which may result in loss of valuable agricultural land and negatively affect rural communities. The discussion document highlighted that the Government intends to introduce limits on the entry of new forests into the NZ ETS on productive farmland and direct afforestation to less productive land to manage this risk.
22. Work is underway to progress this proposal, aiming for Cabinet decisions in late October. Depending on the timing of progress on this work and subject to your direction, we can include an update on this proposal in the final ERP2.
23. Other impacts of the NZ ETS, such as socioeconomic and environmental impacts, will be discussed in a separate chapter on distributional impacts as well as in sector specific chapters.

9(2)(g)(i)



9(2)(g)(i)



9(2)(h)



Next steps

33. We seek your feedback on the draft NZ ETS chapter for the final ERP2. Officials will provide you with a draft of the final ERP2 in early October. It will include an updated version of the NZ ETS chapter.
34. Submissions analysis is underway. Once this is complete, we will provide you with further advice on any revisions to the NZ ETS chapter you may wish to consider.

Appendix: Strengthening the New Zealand Emissions Trading Scheme

*Appendix withheld in full under section 9(2)
(g)(i)*

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