2022 ETS Unit Settings consultation webinars Questions and answers

Where questions have been answered orally these notes are not necessarily verbatim. Some edits have been made for sense and clarity. Additionally, the second webinar recording failed, so we have subsequently written answers to questions received then. Edits are shown in square brackets […].

Webinar date 19 September 2022

Question:

Are all the figures below the top line in the table on pg. 25 in real values?

Answer: Verbally

Yes, they are

Question:

How do the options interact with the forthcoming review of forestry? Shouldn't they be considered together?

Answer: Written

This is not possible because the review of the NZ ETS and how it can drive a balance of gross and net emissions reductions is on a different timeline. These NZ ETS settings regulations must be in place by the end of this year [as required by the Climate Change Response Act 2002].

Question:

Is the lack of details around international credits to meet the NDC (Nationally Determined Contribution) a concern? E.g., what if unlimited cheap low-integrity units become available?

Answer: Verbally

Our international negotiating mandate is on our website and it sets out what the principles are for engaging in international markets to find international mitigation. One of those principles is environmental integrity. [refer here to New Zealand's framework for international carbon market cooperation] It's extremely unlikely that unlimited cheap low integrity units would be used as the government will be only interested in using units that are credible and have environmental integrity.

Question:

How are the CCR (cost containment reserve) units paid back - can they ever represent actual emissions?

Answer: Written

Not all of the CCR volume sold is in addition to the emission budget; some is assumed stockpile reduction. But, yes, the Government must find mitigation to offset the additional allowed emissions, either internationally or domestically. [additionally – this requirement applies where additional volume results in emissions budgets being exceeded – detail is in section 30IA of the Climate Change Response Act 2002: Climate Change Response Act 2002 No 40 (as at 03 November 2021), Public Act 30IA Minister must obtain greenhouse gas reductions to match certain excess units – New Zealand Legislation]

Question:

Your price impacts and narrative on pg. 28-30 do not specify the timeframe short-term and longer-term prices will change as the economy adjusts and substitutions and so on occur – what do the short, medium and long-term marginal cost curves look like?

Answer: Verbally

What we've done is use the emissions pricing component of costs for this. I use petrol as an example because I find it the most straightforward to understand. You're right that if people start substituting biofuels at high rates that the cost per litre attributable to the ETS would reduce, because a proportion of that fuel would no longer be facing an ETS cost. We haven't included it here, because we're trying to get out there a feel for what the impacts are right here, right now and in the medium/short-term.

In terms of long-term marginal costs curves, we can use the people who have tried to predict thermal use for electricity generation as an example. There is a lot of renewable generation in the pipeline, but there's also a lot of uncertainty on the ongoing use of that electricity by major industrial emitters. So, if someone was to shut down, that has implications. For example two or three years ago Refining NZ was not anticipated to cease refinery operations, however they have and that's had various impacts. Not so much the pricing and impacts, but on NZ's emissions. We're going to be talking about that more in our analysis and we're really interested in hearing more on that from submitters.

Question:

Is there a risk high prices increase the supply of units through forestry and therefore not meet the Government's climate goals?

Answer: Verbally

A higher price will affect incentives for afforestation. How that actually plays out in practice is yet to be determined, and the Government is considering the possible effects of this in a range of policy areas at the moment. I encourage you to watch this space in terms of work programs – both on MfE's website, and MPI's. For instance, there was a consultation earlier this year on the permanent forestry category in the NZ ETS, so this is an active area of policy consideration.

Question:

About pg. 17 & 18

So, the issue of the proposed technical adjustment warrants more discussion, and its advice the commission appears to present the discrepancy as established fact, but does not seem to be the case based on the discussion and the consultation document. Can you clarify the status of verification of technical adjustment is likely to be included or not? Is it a different amount?

Answer: Verbally

The discrepancy between the inventory and the ETS reported emissions is real, so yes, that is an established fact. What is unclear is the origin of that discrepancy, including whether, for example there needs to be adjustments to methodology in the inventory. So, we're trying to figure out whether that discrepancy should impact the supply of units effectively and whether there are additional emissions that aren't covered by the ETS.

You're right, it does have an impact that's quite material, and we did consider presenting options such as "If we can't arrive on an answer that's certain of this, should we hedge our bets in one direction or the other – not make any adjustment, make the full adjustment, or somewhere in the middle?" We hope to have the answers on that. Feedback on what we should do about it if we don't reach any certainty is very welcome [please include in your submission].

Question:

Excess Banking (page 20)

The estimation of an excess of 49 million banked units is predicated on an assumption that a reasonable level of hedged volume being 30 million units, which is less than one-year of forward emissions obligations. Is this level of cover not unreasonably low given the current status and uncertainties of the secondary market and the risks of defaulting on surrender obligations?

Answer: Verbally

The Commission has provided a lot of detail on the way it arrived at these estimates of banked units. We are very aware of the inelasticity of demand to price. Penalties for failing to surrender units are stringent. These penalties mean that people, not quite at any price, but close to it, need to acquire units. This may have an impact on selling decisions. Another input into this calculation is hedging levels, some companies publish their hedged volume in their annual reports for example. And we're looking quite closely at different hedging approaches.

When, we've talked about that slide, we presented a range of options, and we're really interested in hearing [your views, including if you have any] alternative views on those options. It's important that we're clear that we haven't included recommended options in the consultation paper. There's a reason for that – we're still working through a lot of the analysis on this.

We don't have visibility on who holds units. That is commercially sensitive information. Although the detail is available in the emissions trading register, it's not something that is released by the Environmental Protection Authority to us or other policy agencies. Whether it's unreasonably low or not, is something that only the holders of those units, and participants are able to [form their own views on, including to support any] decisions being made by those with obligations around hedging.

Question:

Offshore Mitigation (page 21)

Given that offshore mitigation does not appear in the current pathway, and there is little to indicate that it will appear in the future, doesn't this suggest that there remains an on-going rationale for continuing release of the CCR. What other measures other than continuing releases of the CCR are available to prevent NZUs moving directly to the marginal cost of domestic abatement?

Answer: Written

Ideally, NZU values will reflect the marginal costs of abatement, as a purpose of the NZ ETS is to reduce emissions.

Question: Looking at Gross vs. Net reductions pg. 27 & 28

Pg. 27 - Please clarify implications of the statement that the commission's use of gross emissions reduction targets is the fundamental input to its recommendations on price control settings is inconsistent?

Pg. 28 - And how does the second statement that the ENZ model will very likely understate the mitigation response to much higher emissions prices relate to the matters at hand?

Answer: Verbally

NZ's emissions budgets, NDC under the Paris Agreement and emissions targets are based on net emissions; that's the combination of emissions from everything and also removals (e.g., via carbon sequestration and forestry). Net emissions reductions are reductions that can be attributed to those [emissions and removal] sources, gross emission reductions are excluding the contributions of forestry, or other removal activities to that.

What we're pointing out in the consultation document is that the Commission has chosen to use gross emissions reductions targets to inform modelling. Modelling is one of the things that the Commission then uses to inform its recommendations – that's what we mean about that inconsistency. We are very interested in hearing people's views in whether that should influence these unit settings and how much gross emissions reduction should be considered the targets.

In the technical index to the commission's advice on pg. 14, it talks about some of the limitations of the ENZ model, and we are interested in how much, for example, the model doesn't identify any impact on price for emissions from waste or industrial processes as it relates very closely to the matters at hand – spoken in detail in the consultation document.

Question:

Trigger Prices (Page 35)

In terms of the trigger price options presented is the policy objective to rapidly transition to the marginal cost of domestic abatement or to continue moderating carbon prices and the likelihood of continuing release of CCR volumes? Is Option 3 particularly problematic in terms of influencing speculative purchasing of units.

Answer: Written

Speculation is a separate issue. An objective of the NZ ETS is to incentivise emission reductions and removals, and these settings need to help to achieve this objective. It is not a goal of these settings to moderate prices; they need to be in accordance with the prices necessary to meet emission budgets. [price control settings moderate the supply of units via auction at certain price points, and this supply moderation is what is expected to impact prices]

Question:

Is there a control to exclude organisations holding excessive stocks in the coming auctions?

Answer: Written:

That topic is outside the scope of the current consultation. But no, there is no such control nor any view on what is 'excessive'.

Question:

Interested to hear more about what the tangible link is between the CPI (Consumer Price Index), inflation and the price of an NZU. Why is the CPI a driver?

Answer: Verbally

One of the requirements of the act is that inflation is considered when making recommendations or preparing advice on the price control settings. As costs across the economy increase with inflation there is a perceived risk that the price ETS price signal may be left behind and be eaten away by inflationary impacts. That's effectively the reason for including the CPI and the calculation of these cost price control settings. Also though, by virtue of having to consider inflation, we need to look at the impact of various prices on inflation (e.g. if petrol increases by a certain amount a litre that has follow up impacts of costs through the economy) and we're not looking at just CPI, we're looking also at the Household Living Price cost index and we're going to be working with Stats NZ – we've engaged with them to see what impacts various price points might have on inflation (e.g. will they drive inflation rates up).

Question:

How much of the emissions and economic production in NZ is directly involved in the ETS and how much proportionally is exempt – Ag [agriculture] and industrial allocations are not covered?

Answer: Written

Hi, this might be helpful: https://environment.govt.nz/what-government-is-doing/areas-of-work/climate-change/ets/coverage-of-the-nz-ets/

Question:

Will any consideration be given to the recent EU ETS price and governance decisions in regard to setting a benchmark for what changes should be adopted in the NZ ETS settings?

Answer: Written

There is no linkage between the two schemes, other than cost of abatement and availability of technology. A fundamental difference is the use of unlimited removals in the NZ ETS.

Question:

Are you saying the Commission excluded forestry entirely and will meet the targets with only gross reductions?

Answer: Verbally

No, this isn't about meeting targets, this is about the prices that may be required in certain scenarios and situations to enable targets to be met. This question might be better directed to the Commission.

Question:

You seem to mostly be focusing on the demand response and not on the supply side adjustments.

Answer: Verbally

We might not spend as much time on the limit settings part of the presentation as may have been expected. The supply into the market via auctioning is determined by those limits and the calculation steps that are carried out. We didn't spend as much time in the industrial allocation because the allocation per annum today is published and the projections on that are based on some sound assumptions.

Question:

Has there been a consideration on the role of carbon border adjustments to address emissions leakage?

Answer: Verbally

There's some analysis on that idea. It's not within the scope of this consultation though. There's been some recently announced policy decisions on industrial allocation and a reasonably recent consultation on that as well. What we're doing right now is about settings. If industrial allocation was in any way changed, that would impact the subsequent calculation of unit limit settings in the ETS settings, but it is not something that this team is working on actively as a part of this consultation.

Question:

How do firms abate in response to rising emissions prices?

Answer: Verbally

[Such decisions are] Up to firms, there are different opportunities available for activities and some activities are harder to abate, which is very clearly acknowledged.

The Government has set up a number of transitional policies and actions in the emissions reduction plan that are worth reviewing. Some examples include the use of government incentives and decarbonisation fund (run by EECA) that will help industries and firms' uptake of new technologies where capital might be constrained. Abatement is done through fuel switching, through electricity efficiency and through industry changes. There are a number of different ways to do this.

Question:

Was any research completed on how the current or past NZU prices have impacted CO_2 emissions over time? Has the impact been smaller or larger than expected?

Answer: Verbally

There was an ETS review carried out a few years ago and one of the conclusions was that there has been very low if any impact on emissions resulting from the ETS while it was open to international units, and the carbon price was suppressed.

Very recently there was a reform of the ETS, and an amendment act went through in 2020 that made significant changes. For example, there used to be a fixed price option (FPO) that effectively enabled firms/participants in the ETS to pay a cap of $25 to meet the emissions obligations. As that was only removed a couple years ago, it's too soon to tell what's really happening from emissions reductions per se. However, we've definitely seen impacts on our afforestation and land use decisions and we're hearing from people that are looking very closely against the context of an increased price, and making changes to processes and industrial activities.

It's always hard to identify what the counterfactual was, so determining how the economy might be different because we wouldn't have an emissions trading scheme is difficult to work out. So, to measure that impact from the ETS against that counterfactual is nigh on impossible.

Question:

Were any options more stringent than the Climate Change Commission's advice considered?

Answer: Verbally

I suspect you're asking about price control settings. We thought that was a reasonable range of options to present for consultation but we are really interested in hearing any views people have on alternative options, including those outside of the range we're presented. Yes, we did consider presenting, for example, cost containment reserve trigger prices higher than the Commission's recommendations. We chose not to include those in the consultation.

Question:

In regard to price control settings, one downside to a higher price is uncomfortably high prices for certain industries. Is it considered that there can be flexibility by subsidising certain industries that are disproportionately affected, with the extra auction revenue?

Answer: Verbally

We're not considering that as part of the work we're doing. Industrial allocation is an existing policy. [It was mentioned] earlier about different opportunities to gain access to support funding for decarbonisation or emissions reduction projects. And many of those are actually funded by the CERF (Climate Emergency Response Fund) or other avenues. So, in a sense, the auction revenue is already contributing to some of these actions.

Question:

How many participants are on the call?

Answer: Written

There was a maximum of 51, currently down to 41.

Question:

What's the rationale of using one-year unhedged liability as liquidity requirement?

Answer: Verbally

We've been considering various options about alternative target values. It is hard to judge several things: the component of the stockpile of units that are actually liquid, that are actually available for sale and being actively traded. We don't hold that information. We also don't know how people have hedged so we have had to estimate behaviour by participants.

But the idea is that there is some sort of minimum trading volume liquidity we think might be required and at the very least people need to acquire units to meet obligations that they don't already have hedging against. There was a rationale for presenting that option. This is something that, due to some information that we don't have access to, where people in this call will have access to, we're really looking forward to more on views on how that should be looked at. Additionally, the options presented involve reducing that liquid volume by 2030, where previously it has been over 10 years. We're looking at that as well.

Webinar date 21 September 2022

Question:

Kia ora - if the main issue is that there are 144 million stockpiled units, why do the ETS settings allow non-emitting investors (including those overseas) to keep buying and stockpiling NZUs?

Answer: Verbally

No recording [the stockpile moves for two reasons. One is the acquisition and surrender of units by emitters to the Crown to meet ETS obligations associated with their emissions. The other is the supply of units by the Crown, for forestry and other removal activities, industrial allocation, and via auctions. The ability of people without direct ETS obligations to participate in the market is outside the scope of this consultation.]

Question:

How MFE intends on limiting farmland from being wasted on forestry's.

Answer: Written

The Government has received advice from the Climate Change Commission on the role of forestry in the ETS and in our climate change targets and is considering next steps.

Question:

Is there any update on integrating overseas units with the NZ ETS?

Answer: Verbally

No recording. [No, other than there continues to be no integration of overseas units with the NZ ETS]

Question:

Can you explain the logic around the difference of the 11 million units in the stockpile reduction volume (between [the] Climate Change Commission's 49Mt and your 38Mt)?

Answer: Verbally

No recording [This wasn't a difference in the size of the stockpile estimate, it was another option for how much to reduce this component of the stockpile]

Question:

What other consultations (if any) might there be ahead of 2023 re ETS?

Answer: Verbally

No recording. [none that I am aware of]

Question

Where does the Government get the NZUs that it allocates to auctions?

Answer: written

They are created by the Government and issued into the Crown holding account after being allocated unique unit numbers. Sufficient amounts need to be in the holding account to allow for issuance for forestry activities, industrial allocation and for auctions. It is worth noting that NZUs surrendered to the Government to meet compliance requirements are subsequently cancelled i.e., deleted. This consultation covers how many of the NZUs can be auctioned each year. [this is not unit cancellation in the technical term of the Act, but simply means that once surrendered they can't be used for anything else]

Question

Suggest the Government can deal with the stock pile via the following: attaches a real NZU from the Stock pile to units issued to trade exposed industries.

Answer: written

Thanks for the suggestion, Mike. Please ensure you send your thoughts to etsconsultation@mfe.govt.nz or through our webpage at https://consult.environment.govt.nz/climate/nz-ets-limit-and-price-settings-2022/

Question

Can you advise the timeline following closure of submissions for the decisions to be made and then when those decisions can be implemented?

Answer: verbally

Unit settings need to be published in regulations this year. This requires the settings to go through a drafting process and Cabinet wraps up effectively in mid-December. The exact timing of decisions is not up to officials, but we recommend that as soon as decisions are made, they be made public. We will follow our normal process of sending an email out saying tomorrow there will be an announcement. Then the next day (likely morning) before markets open, there will be an email with links to the updated settings.

Question

Can we expect the new settings to be in place for the 2023 calendar year?

Answer: verbally

Amendments to unit settings for the immediately following two years, so 2023 and 2024, can only be considered in certain circumstances. We have met at least two of those circumstances. They include: changes to emissions budgets (with the first emissions budgets being set, this year), sale of the cost containment reserve volume (as has happened this year) and thirdly changes to New Zealand's target under the Paris agreement. [Final decisions have not yet been made, however, if decisions are made to amend unit settings for those years then it is possible that] new settings will be in place for the first auction of 2023.

Question

What rationale underpins the assumption that lowering supply of units at auction will mean those sitting on stockpile will either use them or sell them. It's in their interest to increase [stockpiling] as auction supply reduces and incentives even more stockpiling.

Answer: verbally

The reason for the stockpile adjustment is that the volume out there is considered to be too high. Lowering supply, we are not saying that it will necessarily result in people selling them however people who have surrender obligations will still be required to surrender units to the Crown to meet those obligations so the demand will stay in the short term unchanged.

People will have to acquire units to meet those obligations and there is the potential of price to increase as auction supply reduces and those who hold units will have to make their own decisions about whether or not to sell units and at what price to do so.

Question

Where is the revenue from sale of units spent?

Answer: verbally

There is a Climate emergency response fund, (CERF) is where the revenue goes. The CERF over the next two or three years is funded by the sale of units at auction. This money is used to support emissions reductions across NZ economy.

It was part of the Government's Budget 22 announcements that the Government was redirecting that revenue towards actions from the emissions reduction plan.

Question

Have you considered setting a use by date on NZU's allocated to Industry and Auctioned. i.e. NZU2024 - must be surrendered before 2024.

Answer: verbally

It has been considered. At this stage there is no intent to introduce this (we call it vintaging). If the units would have a vintage or a use by date it would add a lot of complexity. At the moment, there are a few people fond of saying "an NZU is an NZU". They all have the same value and the same ability to be used to meet compliance obligations. There are some potentially quite perverse outcomes that could happen if you introduce vintaging. It sounds like it should work in practice but for people who hedge volumes into the future, it may simply mean they change their accounting model where they decide which units to use first or later and it could do some quite strange things and induce distortions to the secondary market. However, unit expiry has definitely been considered by quite a few people at various times.

Question

The goal of the increasing floor and ceiling prices is to promote emission reductions, and we are budgeting/making plans until 2035. However, today we live in a 10% p.a. inflation world. What role does inflation planning play for setting the floor and ceiling prices?

Answer: verbally

One of the factors that had to be considered when setting the floor and ceiling prices so the auction reserve and the cost containment reserve trigger prices is inflation. First to ensure price signals are not eroded by inflation. Basically, the way that is done is to increase settings to account for inflation, and that is one of the proposals in the consultation document. We are considering using the Treasury's budget economic and fiscal update (BEFU) projections of inflation. BEFU inflation projections are used to moderate or increase those settings or those values. The second thing we need to consider with inflation is potential inflationary impacts of these settings. If the emissions pricing is to increase, the prices of goods has an impact on inflation. We know there are a lot of steps underway to try and mitigate against high inflation rates. Yes, it's been considered in both directions.

Question

How big is the CERF?

Answer: written

You can find more information on the CERF here:
https://www.beehive.govt.nz/sites/default/files/2022-05/CERF%20investments.pdf

Question

How does supply of forestry NZ use and potential of overseas units' impact on option settings?

Answer: verbally

If you look at the series of steps followed in the methodology, it doesn't consider the volume of units transferred for forestry. There's forestry outside of the ETS and this is considered when allocating the emissions budget in the first place. Supply of forestry units does not impact options settings directly. There are questions about the liquidity of the stockpile of privately held units so I guess it is the volume of forestry units, numbers held effectively and preparedness for people to sell them, that impacts the considerations when setting the stockpile adjustments. The Commission has provided an estimate of excess liquidity and if you look at it, you'll see that units held by post-89foresters that were transferred to forestry is considered very closely. I think it's in the technical annex spreadsheet number 1 which is on the Commission's website.

In terms of overseas units, at this stage we do not have any and it's premature to say even if NZ does get overseas units how that will be treated. Whether they'll be made available into the scheme, whether they'll be separated. Those decisions have not been made.

Question

As the Government regulated the supply and demand, why doesn't the Government just set the price?

Answer: verbally

Effectively what you are asking is why don't we have a carbon tax instead of the emissions trading scheme. The intent of this emissions trading scheme is to allow firms or emitters to discover the way in which emissions reductions can be made and to have ownership of the least cost, most efficient way in which those reductions are made. Whether that be investing in forestry to remove carbon dioxide from the atmosphere or, whether to invest in a new technology.

Question

When will the slides be available or were you intending to post these slides after this webinar is complete?

Answer: verbally

We will try get these out as soon as possible soon and will advise attendees when released.

If not available this week, early next week.

Question

Can you share with industry stakeholders the model that developed your options put forward in this consultation as opposed to the Climate Change Commissions advice?

Answer: verbally

The options for price control settings are informed by the Commission's modelling and/or adjustments to the status quo.

Question

To reach net zero by 2050, one mechanism would be to set a year-on-year reduction of units of 10% or a little more by now. This feels like a simple mechanism that then lets the market decide how this is achieved. Are the controls we are discussing are political decisions comparted to using the above simple method.

Answer: verbally

[Thanks for the suggestion. Please ensure you send your thoughts to etsconsultation@mfe.govt.nz or through our webpage at https://consult.environment.govt.nz/climate/nz-ets-limit-and-price-settings-2022/]