

Reforming industrial allocation in the New Zealand Emissions Trading Scheme

Summary of submissions



Ministry for the
Environment
Manatū Mō Te Taiao



Te Kāwanatanga o Aotearoa
New Zealand Government

Disclaimer

While all care and diligence has been used in processing, analysing, and extracting data and information for this publication, the Ministry for the Environment and the data providers give no warranty in relation to the report or data used in the report – including its accuracy, reliability, and suitability – and accept no liability whatsoever in relation to any loss, damage, or other costs relating to the use of any part of the report (including any data) or any compilations, derivative works, or modifications of the report (including any data).

This document may be cited as: Ministry for the Environment. 2022. Reforming industrial allocation in the New Zealand Emissions Trading Scheme: Summary of submissions. Wellington: Ministry for the Environment.

Published in March 2022 by the
Ministry for the Environment
Manatū Mō Te Taiao
PO Box 10362, Wellington 6143, New Zealand

ISBN: 978-1-99-102506-7

Publication number: ME 1619

© Crown copyright New Zealand 2022

This document is available on the Ministry for the Environment website: environment.govt.nz.

Contents

Tables	3
Introduction	4
Background to industrial allocation policy	4
The review of industrial allocation	4
Purpose of consultation	5
Who responded to the consultation	5
Criteria assessment	6
Allocation calculations	8
Broader options to reform industrial allocation	14
New activities	14
Data reporting requirements	15
Future of IA policy	17
Alternative mechanisms to industrial allocation	17
Encouraging emissions reductions	18
Wider considerations	19
Other comments	21

Tables

Table 1: Number of submissions by submitter group	5
---	---

Introduction

From 8 July to 17 September 2021, the Ministry for the Environment (the Ministry) consulted on a range of options to improve industrial allocation (IA) policy in the New Zealand Emissions Trading Scheme (NZ ETS).

This report summarises the views expressed in response to the consultation document – *Reforming industrial allocation in the New Zealand Emissions Trading Scheme*. It does not provide an analysis of those views, or recommendations in response to them. Any recommendations in response to these submissions will be made through policy development and advice to the Government.

Background to industrial allocation policy

IA is the provision of free emissions units (New Zealand Units or NZUs) to industries considered emissions-intensive and trade-exposed (EITE)¹.

IA reduces the cost impact of the NZ ETS for EITE industry with the purpose of reducing competitiveness issues with offshore firms subject to weaker climate policy. Asymmetrical climate policy could risk driving EITE firms, production and the associated emissions overseas, which could increase global emissions. This risk is known as ‘emissions leakage’.

IA was first introduced to the Climate Change Response Act 2002 (the Act) in 2009 in advance of industrial activities being brought into the NZ ETS in mid-2010. It is provided annually on a production basis to firms who carry out any of the 26 eligible activities². Many international emissions trading schemes use allocation as a form of mitigating emissions leakage.

The review of industrial allocation

The Government called for a review of IA policy in 2020 after it was identified that out-of-date settings were causing windfall gains to some industries due to the over-allocation of NZUs.

A data collection was performed in mid-2020, which collected revenue, production and emissions data from a selection of four EITE activities. The resulting analysis determined that all four were over-allocated; and three of the activities were receiving more than 100 per cent of their emissions costs.

Since IA was first developed, New Zealand has moved into a new era, putting climate change at the heart of government decision making. IA policy sits within a set of broader climate change objectives for New Zealand. The Government has committed to reducing emissions to meet domestic and international climate targets. Current levels of IA, in combination with the likely over-allocation across many eligible activities, are unsustainable within the context of New Zealand’s future emission budgets.

¹ Emissions-intensive – meaning an activity produces a significant portion of emissions relative to the revenue generated from the product, and trade-exposed – meaning the activity is exposed to international trade. A more detailed definition can be found in the consultation document.

² <https://www.legislation.govt.nz/regulation/public/2010/0189/latest/DLM3075101.html>

Purpose of consultation

The Government consulted on IA from 8 July 2020 to 17 September 2020. The consultation document, *Reforming industrial allocation policy in the New Zealand Emissions Trading Scheme*, explained the current issues with IA and sought feedback from the public on a package of options to rectify these issues. The Ministry is undertaking final policy analysis, which will consider submitters views. It is expected final policy decisions will be sought mid-2022.

Who responded to the consultation

The Ministry received a total of 190 submissions. These were either received through the Ministry's consultation tool – Citizen Space, or via email. The total number of unique submissions was 181.

A large number of submissions from individuals were based on a similar template and largely repeated the same four points. Thirteen of the submissions were from firms who are eligible to receive IA.

The profile of submitters is itemised below.

Table 1: Number of submissions by submitter group

Submitter type	Number
Individuals	138
Iwi	1
Environmental NGO	11
Business group	8
Energy group	3
Allocation recipient	13
Other industrial	1
Other	6
Total	181

Criteria assessment

The IA consultation document outlined five criteria which each proposal was assessed against.

Supports the purpose of the NZ ETS. IA should drive mitigation in line with emissions budgets, and make a meaningful contribution to lowering global emissions. It should ensure an appropriate incentive is maintained for EITE firms to reduce emissions.

Addresses over-allocation. IA should avoid unacceptable levels of over-allocation.

Addresses the risk of emissions leakage. IA should continue to minimise the risk of leakage. It should mitigate the loss of competitiveness for EITE firms that face higher costs because of the NZ ETS, and prevent the export of domestic industries that increase global emissions.

Regulatory certainty and predictability. Changes to IA should give recipients certainty. Future allocation policy needs to be predictable over typical investment horizons.

Minimises administrative burden and complexity. IA should support an efficient NZ ETS, which minimises administrative costs, as well as compliance costs and burden for EITE firms.

Question 1: Do you agree with the five criteria to assess the proposals in this consultation document?

Fourteen per cent of submitters agreed with all five assessment criteria. Nine per cent of submitters disagreed and 76 per cent of submitters either didn't answer or were not explicit on whether they agreed with the five assessment criteria. Some submitters may have agreed with some of the criteria or suggested caveats or changes to a particular criterion.

A large number of submitters used this section to communicate views unrelated to the policy criteria. These covered issues such as removing the NZ ETS entirely, stopping allocation, capping IA, and only allowing IA for industries with emissions reduction plans.

Pan Pac Forest Products Limited (Pan Pac), New Zealand Steel (NZ Steel), Winstone Pulp International (WPI), Evonik Peroxide Limited (Evonik Peroxide), Ballance Agri-Nutrients Limited (Ballance Agri-Nutrients), a group of reconstituted wood panel businesses (RWPS)³, the Wood Processors and Manufacturers Association of NZ (WPMA), Golden Bay Cement, and Graymont either cautioned against the definition of over-allocation used in the consultation document or disagreed outright. They either noted that defining over-allocation as greater than intended under the Act is a circular argument, or that over-allocation should be considered a return on investments to reduce emissions. Some proposed that over-allocation should be defined as more emissions units than the direct and indirect emissions from the activity.

Three per cent of submitters (individuals and ENGOs) disagreed that emissions leakage risk exists or suggested that it is over-stated. Many more stated that as more countries increase their climate ambition, the argument of leakage will become less plausible.

³ This group submitted on behalf of the Reconstituted Wood Panels Sector and consisted of Nelson Pine Limited, Daiken New Zealand Limited, Daiken Southland Limited, and Juken New Zealand Limited). This group is referred to as RWPS from the rest of this report.

Some submitters, including Parents for Climate Aotearoa and Southland Forest and Bird Committee, suggested there needs to be an additional criterion that addresses fairness and climate justice.

Some specific points raised were:

- Pan Pac would like to see an additional criterion on the economic contribution of EITE industry to be consistent with the Act
- Holcim New Zealand Limited (Holcim) agreed with all five criteria but noted that IA fails on all, and that policy changes to IA would not sufficiently address New Zealand's decarbonisation goals
- Horticulture New Zealand (Horticulture NZ) would like to see a criterion on food security and feasibility of transitioning
- NZ Steel proposed an additional criterion considering the risks of unintended or irreversible consequences, such as productivity of sectors, skills, and employment.

Allocation calculations

The consultation document identifies allocative baselines derived from decade-old data as the main cause of over-allocation. Feedback was sought on whether these baselines should be updated to reflect recent emissions intensity trends. Feedback was also sought on how often it would be appropriate to update allocative baselines, and what years would be most appropriate for a first update.

Question 2: Should allocative baselines be updated using new base years?

Thirty-two per cent of submitters agreed allocative baselines should be updated using new base years. Some of these mentioned that if baselines were updated, it is important to ensure investments are not undermined. Seven per cent thought an update should not occur – predominantly because it would undermine investments already made to reduce emissions, and disincentivise future investments. Some of these submitters were also concerned about the potential overlap of updating allocative baselines and increases in the phase-out rate which could be occurring in the future.

Sixty-one per cent of submitters either didn't answer or were not explicit about whether they agreed baselines should be updated. Of the submitters that did not specifically answer this question, the vast majority opposed allocations altogether or thought that all allocations need to be phased out by 2030. Many submitters agreed with the Ministry's position that windfall gains to EITEs is inappropriate and that there is no evidence that over-allocated industries have 'specifically' utilised allocations to invest in emissions reductions. Of the 12 EITE industries that receive IA and submitted, six of them agreed that allocative baselines should be updated with new base years – including NZ Steel and Methanex, which account for over 40 per cent of allocations.

Question 3: Should the reassessment be a one-off update, or a periodic update?

Many submitters (32 per cent) supported periodic updates of allocative baselines, while a small minority favoured a one-off reassessment (two per cent). The remaining submitters either did not answer or were not explicit in their answer. Of the submitters who favoured a one-off reassessment, the majority cited business certainty as the predominant factor. A couple of submitters indicated that a one-off reassessment might cause even more uncertainty than a periodic reassessment as it could lead to ad-hoc government interventions. The Carbon Shop Ltd indicated the need for periodic assessment due to changes in activity profile.

Question 4: If periodic reassessment is legislated, what would be an appropriate period – every year, 5 years, 10 years, or something else?

If a periodic reassessment were to be legislated, 20 per cent of submitters thought this should be undertaken annually. Generally, these submitters wanted to see allocations completely phased out by 2030. Six per cent thought a periodic update to the baseline years should be every five years as this provides a good balance between investment certainty and over-allocation risk. Others favoured a five-year period as it balanced administration costs with the need for data accuracy. It was also observed by some submitters that five years aligns with New Zealand's emissions budgets set under the Zero Carbon Act.

Five per cent thought it should be every 10 years, citing the need for business investment certainty. Another five per cent thought it should be some other period, while 65 per cent

either didn't answer or were not explicit in their answer. Of the submitters who indicated some 'other period' to update allocative baselines, the vast majority thought greater than 10 years was needed, and many said 15 years or more would be appropriate as this longer timeframe aligned with their investment cycles. Two submitters said that updates should be every two years.

A few submissions mentioned that some firms should be allowed to defer the periodic reassessment if it were to coincide with an investment decision. Additionally, a few submitters were worried that periodic reassessments of allocative baselines and the Climate Change Commission's ability to recommend increased phase-out rates might double up a reduction in allocation.

Question 5: Do you agree the financial years 2016/17, 2017/18 and 2018/19 should be used as new base years to update allocative baselines?

Twenty-two per cent of submitters disagreed that the financial years 2016/17, 2017/18 and 2018/19 should be used as new base years to calculate allocative baselines. Almost all these submitters reasoned that by the time the new baselines come into effect, they would be out of date. Eight per cent agreed that these years would be appropriate, and 71 per cent either did not answer or were not explicit in their answer. Of the submitters who answered 'no', many said that baselines should be updated each year.

Question 6: Should the financial years 2019/20 and 2020/21 be included, but with a weighting provision?

Twenty-three per cent of submitters agreed that the financial years 2019/20 and 2020/2021 should be used but with a weighting provision. Two large allocation recipients (Evonik Peroxide and Ballance Agri-Nutrients) were comfortable using these base years as they were classed as an essential service and operated through COVID-19 lockdowns.

Ballance Agri-Nutrients said the use of calendar years should be considered as they would align better with NZ ETS compliance and allocation periods. One submitter said that different weightings might be needed for each industry, as COVID-19 has impacted businesses to differing levels. Six per cent disagreed, and 71 per cent either did not answer or were not explicit in their answer.

Eligibility

The consultation document discussed reforming the basis for eligibility of EITE activities to receive an allocation. Feedback was sought on the construction of the emissions intensity criteria, including whether:

- the eligibility status of EITE activities should be updated with new baselines' years
- New Zealand-specific eligibility thresholds should be developed
- additional thresholds or a sliding scale system should be implemented to better target eligibility
- whether the New Zealand electricity allocation factor (EAF) should be used to determine an activity's eligibility status rather than the Australian EAF

The consultation document also discussed the suitability of the current trade exposure criterion to determine an industry's ability to pass on costs to consumers.

Question 7: Should eligibility be reassessed using new base years?

Twenty-eight per cent of submitters agreed that eligibility should be reassessed using new base years, with some arguing a need to remove as many IA recipients as possible. Some large allocation recipients (Methanex, Graymont, and NZ Steel) agreed that eligibility should be reassessed. Methanex caveated its response, saying as long as the emissions intensity is based on an average over multiple years. Horticulture NZ stated it was not opposed to an update of eligibility using new base years, but only if the benefit of doing so outweighed the costs of implementing such a change.

Six per cent disagreed with reassessing eligibility with new base years, predominantly because this would penalise investments made to reduce emissions, or create uncertainty. Most submitters that disagreed were allocation recipients in the wood and pulp sector. Sixty-six per cent either did not answer or were not explicit in their answer. WPI – an allocation recipient – suggested an assessment of emissions intensity (which determines eligibility) should include a biomass allocation factor to account for the NZ ETS price on feedstock and fuel.

Question 8: Should new emissions intensity thresholds for New Zealand industry be developed?

Twenty-six per cent of submitters agreed that New Zealand emissions intensity thresholds should be developed, with some reasoning that thresholds based on the then-proposed Australian scheme is inappropriate and outdated.

Three per cent either disagreed – including Graymont and Oji Fibre Solutions NZ Limited (Oji Fibre Solutions), or were not opposed to the current thresholds – including NZ Steel and Methanex. Graymont said there would be no discernible gain from developing New Zealand-specific thresholds, while Oji Fibre Solutions said that emissions intensity will always be approximate and there is unlikely to be meaningful gain from alternative options.

Seventy-one per cent either did not answer or were not explicit in their answer. Pan Pac, WPI, WPMA, Evonik Peroxide, and Ballance Agri-Nutrients said that any new thresholds should consider increases in the price of carbon.

NZ Steel proposed a second test for activities which become ineligible. At a minimum, it would like it to consider the precedent of whether the activity is covered in other international schemes, and the potential for emissions leakage.

Additionally, some submitters (predominantly industry) would like to see the thresholds updated to consider the cost of carbon.

Question 9: Should more thresholds be added into the eligibility criteria? How many would be appropriate?

Twenty-four per cent of submissions agreed that more thresholds should be added, with over half of these stating that thresholds should only be added if it resulted in a reduction of over-allocation (predominantly individuals). Submitters were not clear as to how the addition of new thresholds would reduce over-allocation. Two per cent disagreed, including Graymont which opposed additional thresholds due to the uncertainty and cost created for now obvious gain. Seventy-three per cent either did not answer or were not explicit in their answer.

Some submitters suggested additions or alterations that would soften the treatment of eligibility.

- Essity Australasia (Essity) suggested that lower thresholds should be developed and that a tiered structure would mitigate the impacts of falling below a threshold.
- Ballance Agri-Nutrients suggested that a secondary screening is included if an activity has a change in eligibility.
- Evonik Peroxide, Ballance Agri-Nutrients, and Pan Pac suggested that if an activity drops below a threshold, then its step change in allocation is moderated through additional thresholds.
- RWPS were concerned about falling below a threshold and losing eligibility. It was in favour of additional thresholds to mitigate this risk.

Question 10: Would a sliding scale threshold system better target eligibility and assistance?

Twenty-two per cent of submitters agreed that a sliding scale threshold system⁴ would better target eligibility (Pan Pac, Essity, Coal Action Network, NZ Steel, Evonik Peroxide, Ballance Agri-Nutrients, WPI, Golden Bay Cement, Horticulture NZ, RWPS, individuals). A majority only supported additional thresholds if it reduced over-allocation. Three per cent disagreed or were in favour of the status quo, including Oji Fibre Solutions, Graymont, and Methanex. Seventy-five per cent either did not answer or were not explicit in their answer.

Horticulture NZ, Golden Bay Cement, Evonik Peroxide, Ballance Agri-Nutrients, Pan Pac, and RWPS agreed that a sliding scale would be beneficial as it would either provide better support to industries or would help reduce distortions if activities fall short of a threshold.

One individual mentioned that a sliding threshold could increase the risk of gaming the system. Another said that a sliding scale could cause uncertainty when a review occurs.

⁴ Using a sliding scale would create a bespoke level of assistance for each activity proportional to their emissions intensity.

Question 11: Should the New Zealand EAF be used when determining eligibility?

Twenty-five per cent of submitters agreed that a New Zealand EAF should be used when determining eligibility (Ngai Tahu, Essity, individuals, various ENGOs). Six per cent disagreed – almost all these submitters were allocation recipients, and 69 per cent either did not answer or were not explicit in their answer. A few submitters mentioned that if a New Zealand EAF were to be used, the emissions intensity thresholds would require a corresponding adjustment.

Pan Pac considered that the current Australian EAF is better suited for eligibility purposes because it accounts for leakage risk from competing Australian production. Golden Bay Cement stated there would be an increase in leakage risk if the New Zealand EAF was used to determine eligibility because of low-cost thermal power offshore.

NZ Steel, on net, supported the retention of the existing Australian EAF. It mentioned that using the New Zealand EAF would result in substantial changes to eligibility and therefore the thresholds would require a reset, which would involve considerable effort. It also said additional complexity to eligibility is not justified given the “blunt policy instrument” of the phase-out of the levels of assistance.

Question 12: Should periodic updates of the EAF trigger a recalculation of eligibility?

Twenty-two per cent of submitters agreed that eligibility should be reassessed if there is an update to the EAF – the majority being individuals or environmental groups. Eight per cent disagreed (predominantly industries) and 71 per cent either did not answer or were not explicit in their answer.

Ballance Agri-Nutrients, Evonik Peroxide, RWPS, Golden Bay Cement, and Essity noted that tying updates of the EAF to a reassessment of eligibility would cause too much uncertainty. NZ Steel said that if the NZ EAF is used for the purpose of eligibility, any eligibility reassessment should occur at the same frequency as the updates to allocative baselines.

Question 13: Should the trade exposure test be changed?

Question 14: What would be a more appropriate method to determine trade exposure?

Submitters tended to provide general and overlapping feedback on trade exposure.

Twenty-five per cent of submitters agreed that the trade exposure test should be updated (predominantly individuals and ENGOs). The majority reasoned that the current trade exposure criterion was too weak. Eight per cent disagreed that the trade exposure test should be updated and 67 per cent either did not answer or were not explicit in their answer.

Almost all submitters that were against updating the trade exposure test were allocation recipients. NZ Steel and Graymont said there is little point in expanding or updating the trade exposure criteria as they are clearly eligible, or that it would add unnecessary complexity, while Evonik Peroxide saw little benefit from doing so. Ballance Agri-Nutrients said the current test is appropriate for urea production, but that considering activities in other trading schemes could reaffirm trade exposure.

Some submitters (14 per cent) said the onus should be on businesses to prove they are trade-exposed. The majority supporting this statement came from individual submitters.

Ecologic mentioned that current trade exposure criteria (and emissions intensity criteria) do not take into account overseas policy, which is a significant consideration in determining leakage risk.

Suggestions on updates to the trade exposure criterion were:

- a refined trade exposure test could be used that considers the amount of international and domestic trade
- tests similar to those used in the Californian or European Union emissions trading schemes
- a two-stage screening, which could be more effective at determining trade exposure (NZ Steel)
- EITE decisions in other jurisdictions could be used to determine trade exposure (Ballance Agri-Nutrients)
- a more detailed analysis of trade exposure could be conducted if no international precedent existed (WPMA and Evonik Peroxide).

Broader options to reform industrial allocation

The consultation document also discussed other options for reforming industrial allocation. The current policy framework was developed over 2009–2010 and within the context of the allocation system developed for the proposed Australian Climate Pollution Reduction Scheme, and New Zealand’s weaker climate ambition at the time.

Options covering eligibility for new activities, data reporting, and simplification of regular baseline updates are discussed.

Question 15: Do you agree with the proposal to simplify the process to update allocative baselines, to reflect changes to emissions factors, EAF or other changes to methodology?

Twenty-four per cent of submitters agreed that the process to regularly update allocative baselines should be simplified (predominantly individuals but also some industries). Two percent disagreed including Golden Bay Cement who said this would create too much uncertainty for industries. Seventy-five per cent either did not answer or were not explicit in their answer.

NZ Steel said that the parameters or criteria should have some constraints to provide a level of certainty to industries. Oji Fibre Solutions agreed there is a need for simplicity but that ideally, a reduction in allocation should be linked to the overall NZ ETS emissions cap.

Pan Pac, Evonik Peroxide, and Ballance Agri-Nutrients said that the updates should be limited to the EAF and emissions factors only. A few submitters said that this should only be allowed if it was predictable and provided stability and certainty to industry. Some said that it needed to be a straightforward process, with one submitter reasoning it should be implemented through a software package.

Question 16: Are there other changes to sections 161A-E of the Act that could better streamline IA processes?

Four per cent of submitters agreed that there are other changes that could better streamline IA. Two percent disagreed that other changes were needed and 94 per cent either did not answer or were not explicit in their answer. Twenty-two submitters (almost all individuals) said that any changes to these sections of the Act should contribute to emissions reductions.

Oji Fibre Solutions, WPI, and WPMA would like to see biofuels added as a fuel source eligible for industrial allocation. Ballance Agri-Nutrients requested that the “direct use of carbon dioxide not produced as part of the activity” is added as an emissions source eligible for allocation – and with retrospective effect back to 2016.

New activities

Question 17: Do you agree with the proposal to clarify the eligibility process for new activities? Why, or why not?

Question 18: Should new activities be able to seek eligibility? Why, or why not?

Question 19: Should there be any caveats on new activities seeking eligibility, such as proof of environmental benefits compared to existing activities?

Submitters tended to provide general and overlapping feedback on these questions.

Seventeen per cent of submitters (predominantly industries) agreed that the process for new activities to seek eligibility should be clarified. Ngai Tahu and some environmental organisations also agreed but only if this were for activities with no fossil fuel use or did not cause a rise in emissions. Ten per cent disagreed – the majority being individuals, and some environmental groups. The apparent reason for not wanting eligibility provisions clarified was that they didn't want to see any new activities able to seek eligibility. Seventy-three per cent either did not answer or were not explicit in their answer.

Nineteen per cent of submitters agreed that new activities should be allowed to seek eligibility, with the majority supporting only if there was environmental benefit. WPMA said that new wood activities should be allowed to seek eligibility. Fourteen per cent disagreed, and 67 per cent either did not answer or were not explicit in their answer. Energy Resources Aotearoa said that new activities should not be able to seek eligibility as they are able to factor the NZ ETS into their commercial plans.

Fifteen per cent of submitters agreed there should be some form of caveat when a new activity seeks eligibility. Some agreed that new activities should only be allowed if they were replacing a higher-emitting activity (and subject to rigorous scrutiny). Pan Pac, Evonik Peroxide, Ballance Agri-Nutrients, WPI, and RWPS said an assessment of the benefit to global emissions would be appropriate. Twelve per cent disagreed, including Golden Bay Cement who said eligibility should be treated consistently. One submitter from the energy industry disagreed and said that the process would be too subjective. Seventy-three per cent either did not answer or were not explicit in their answer.

Data reporting requirements

Question 20: Should firms that receive IA be required to report their emissions, revenue and production data annually? Why, or why not?

Question 21: Would voluntary reporting be more appropriate, and still provide some oversight of leakage and over-allocation risk? Why, or why not?

Thirty-two per cent of submitters agreed that it should be mandatory for allocation recipients to report relevant data. Some submitters qualified this with caveats such as confidentiality provisions, or no requirement to report revenue data. The primary justification for mandatory data reporting was a need for market transparency.

Three per cent disagreed with the need for mandatory data reporting (Essity, Graymont, WPMA, WPI, Horticulture NZ, individuals). Some of these cited confidentiality concerns, or increased compliance/administration costs. Sixty-five per cent either did not answer or were not explicit in their answer.

Some specific points from submitters were:

- Evonik Peroxide, Ballance Agri-Nutrients, and Pan Pac supported the reporting of production and revenue data and noted that some of this is already disclosed. Both support the voluntary reporting of revenue data, citing commercial sensitivity concerns

- Oji Fibre Solutions said it has no issue with reporting data but that it is not sufficient to use data on its own to monitor IA. Other measures are needed to monitor international competition
- Graymont stated that production and emissions data could be provided to the Climate Change Commission
- The Climate Change Commission made a special request that its role in providing advice to the Government on IA be considered when making decisions around data reporting requirements of allocation recipients
- some individual submitters said data reporting would require independent auditing and a few submitters said that profits and margins should also be reported
- Stratterra said that small businesses should be exempt to minimise compliance costs
- NZ Steel agreed that production and emissions data should be reported (mentioning this is already provided to the EPA); however, it opposes reporting revenue data, citing volatility, uncertainty around which financial information standards would be used, and incompatibility with the Act's reporting periods and financial years.

Two per cent of submitters thought that data reporting requirements should be voluntary (note that some of these submitters were also in favour of partial mandatory reporting and partial voluntary reporting).

Twenty-nine per cent disagreed with voluntary reporting requirements – these were predominantly individuals. These submitters commonly said that voluntary reporting could lead to gaming the system. Additionally, they said that allocation recipients must report against an emissions reduction plan. Sixty-nine per cent either did not answer or were not explicit in their answer on voluntary reporting.

Question 22: Should the five-year transition period for changes in eligibility status remain, or be changed?

There were mixed views on whether the existing five-year transition period for changes in eligibility status to take effect should remain. Six per cent of submitters did not want the five-year transition retained – these were predominantly individuals. Reasons for removing the transition period included allowing the timely implementation of these IA reforms to address over-allocation. Some submitters said firms should be able to measure their own emissions intensity and plan accordingly to account for changes in their eligibility, therefore removing the need for a transition period.

Seven per cent of submitters wanted the five-year transition period to remain (these were all allocation recipients or entities related to industry). Supporters argued it provides certainty for recipients and could mitigate disruptive impacts from eligibility changes. Pan Pac recommended indefinitely extending the transition period until recipients had recovered the costs of investments funded through allocations.

Seventeen per cent of submitters wanted the transition changed to one year (all individuals or ENGOs), and two per cent wanted some other transition. Horticulture NZ supported a longer 10-year transition period to provide certainty to recipients, and others supported somewhere between two and five years. Sixty-nine per cent either did not answer or were not explicit in their answer.

Future of IA policy

The Government also sought feedback on the future direction of IA policy. This was framed as a high-level discussion on whether the phasing or replacement of the current system with alternative mechanisms might better account for growing international climate ambition and the changing landscape of competitiveness issues and emissions leakage.

Alternative mechanisms to industrial allocation

Question 23: Should we look at an alternative mechanism to address emissions leakage?

Question 24: What alternative mechanisms to IA would better address the risk of emissions leakage, and support domestic and international emissions reduction targets?

Thirty-one per cent of submitters agreed that the government should look at alternative mechanisms to address emissions leakage. A third of this group favoured the use of a carbon border adjustment mechanism (CBAM) and almost half favoured the use of funding. Three per cent disagreed that the government should look at alternative mechanisms. Sixty-six per cent either did not answer or were not explicit in their answer.

Some specific points from submitters were:

- nine per cent of submitters said that an alternative mechanism should support decarbonisation. These were predominantly individuals
- Oji Fibre Solutions said alternative measures are needed to support at-risk industry, especially for the wood sector. Policies should directly encourage emissions reductions
- Holcim favoured removing IA completely by 2025 and replacing it with a CBAM. It stated there is no cost differential between high and low carbon intensity products because IA absorbs the impact. It also stated that cement alternatives are available now, but the economic incentive to move to these alternatives is muted
- NZ Steel were not wedded to any mechanism but indicated that any new policy should protect against leakage, be simple and avoid unintended impacts
- WPMA said that New Zealand's greenhouse gas regulation needs to align with the European Union's proposed CBAM
- Federated Farmers submitted that an alternative framework such as a CBAM would advantage international competitors. It would prefer for the current IA system to be improved
- Aluminium Extruders Association of New Zealand was concerned with the import of aluminium products lacking a carbon price. It advocated for a CBAM on imported products that takes account of the exporting nations emissions intensity
- Evonik Peroxide, Pan Pac, Ballance Agri-Nutrients, WPMA, and RWPS stated that if a CBAM was implemented, it should be well communicated, and firms should be no worse off than under IA
- OMV New Zealand Limited noted that it is not obvious that an alternative to IA is needed and that the current system should be monitored after updates to the allocative baselines. It also noted that a CBAM would not apply to exports due to trade rules

- Energy Resources Aotearoa preferred IA to remain but expressed support for a one-off payment over constant updates to industrial allocation policy. Additionally, it highlighted that a CBAM would be administratively difficult, not in the spirit of fair trade, and wouldn't solve export issues
- Graymont does not favour the use of a CBAM due to its complexity and trade relation risks
- Horticulture NZ was concerned about imported products not subject to a carbon price displacing New Zealand production. It supported direct cash payments to EITE firms, citing that it would be administratively efficient. It did not support a partial exemption because it would provide limited assurance to growers as they do not have direct surrender obligations. It also noted there are pros and cons to the use of a CBAM and considered it would be better to monitor international developments in this area before implementing such a change
- Ecologic supported the development of a Climate Emissions Border Adjustment Mechanism (CEBAM)⁵, as the current system dampens the incentive to invest in greener production methods, and a CEBAM system that is World Trade Organisation compliant would provide greater scrutiny to the rationale for protection. It recommended that a CEBAM should be phased in no later than 2026.

Encouraging emissions reductions

Question 25: Should IA policy or any alternative explicitly encourage firms to reduce emissions?

Question 26: What method could be used to encourage emissions reductions?

Twenty-three per cent of submitters agreed that IA or any alternative mechanism should explicitly encourage emissions reductions (mixture of allocation recipients, ENGOs and individuals). Four per cent disagreed – with some noting that IA policy currently does this. Others who disagreed said the best way to incentivise emissions reductions is to remove IA completely. Seventy-three per cent either did not answer or were not explicit in their answer.

Oji Fibre Solutions was interested in seeing incentives such as grants and tax rebates to balance out 'punitive' measures such as the carbon price and regulatory controls. It noted that the limited direct support provided to large industrials by the Government Investment for Decarbonising Industry and the Provincial Growth Fund are too small for its possible \$600 million bio-energy project. Additionally, many submitters indicated funding was necessary to encourage emissions reductions. Many submitters said the current system already provides an incentive to reduce emissions.

Some related points from submitters were:

- The Carbon Shop Ltd said IA intrinsically encourages emissions reductions through static baselines but notes this is often not factored into project planning except for in very large projects. It noted other tools and policies to explicitly encourage emissions reduction should be leveraged so as to not make IA more complex

⁵ Ecologic use the term Climate Emissions Border Adjustment Mechanism as non-carbon emissions dominate New Zealand's emissions profile. It is, however, analogous to a CBAM.

- one submitter from the energy industry said that IA is not the right place to tackle emissions reductions and that a capped ETS linked to budgets is the best way to reduce emissions
- Ballance Agri-Nutrients and Evonik Peroxide said the current output-based system already provides a clear incentive to reduce emissions intensity and would be undermined through frequent updates
- Golden Bay Cement said that IA policy or any alternative should explicitly encourage emissions reductions but not then penalise this by updating baselines
- many submitters said IA firms should be required to have a verifiable decarbonisation plan and regular review of meeting their targets. Additionally, they said a higher shadow price should be used by the government – however, it was not made clear how this would achieve the outcome of encouraging emissions reductions among EITE activities.

Wider considerations

Question 27: Should IA decisions or any alternative include wider considerations – such as economic, social, cultural and environmental factors – when determining support for industry?

Question 28: How would these new considerations interact with the goal of reducing emissions leakage?

Twenty-seven per cent of submitters agreed that IA policy or any alternative should include wider considerations. Agreement came across the board from ENGOs, EITE industry, and individuals. Of those in agreement, 45 per cent mentioned Te Tiriti o Waitangi as a consideration.

Two per cent of submitters disagreed that wider considerations should be part of IA or an alternative. One submitter from the energy industry said IA was designed to protect against carbon leakage and was not an appropriate place to tackle broader issues. Seventy-one per cent either did not answer or were not explicit in their answer.

Graymont said that current IA policy already implicitly includes wider considerations to protect economically important industries which keep jobs in New Zealand. It suggested other policy levers can be used to specifically tackle wider issues.

Evonik Peroxide and Ballance Agri-Nutrients argued that a singular focus on emissions leakage is out of step with international thinking and does not recognise the challenges facing hard-to-abate industries.

Some submitters voiced wider considerations such as:

- Pan Pac recommends economic benefits are considered
- Oji Fibre Solutions would like to see energy supply issues considered
- NZ Steel listed a number of additional considerations, including, domestic supply chain resilience, employment and wellbeing, and education and job skills
- WPMA indicated a comprehensive list, including least economic cost of climate policies and protection to regional economies

- Evonik Peroxide was in favour of wider considerations, including supply security and the economic benefits of retaining domestic production
- WPI suggested that consideration to broader national interests, such as employment, regional economies and least cost achievement of climate change goals
- Golden Bay Cement said economic considerations and domestic supply reliability should be considered
- Horticulture NZ suggested the purpose of IA should shift to maintaining food security and driving global emissions reductions
- many submissions said holistic thinking, the 1.5-degree climate goal, just transition and Te Tiriti o Waitangi should all be considerations. These were predominantly from individuals and some ENGOs.

Other comments

Question 29: Do you have any other comments, ideas or feedback that could help support the Government form final policy decisions?

Many submitters used this opportunity to voice concerns and views unrelated to the consultation. These have not been accounted for in this report.

Additional views relevant to the consultation were:

- reductions in allocation should be removed from the emissions budget
- significant support for the removal of fossil fuel subsidies but the use of grants to aid a just transition
- concern around energy supply issues and the need for reliable low-emissions energy
- concern around compounding impacts on business from other reforms
- concern around allocation reform undermining investment cases
- administration costs related to IA should be reduced through system-based reporting which can also work as a method of monitoring
- IA reform needs to be in the context of the Emissions Reduction Plan
- the allocation calculation needs to have an explicit link to carbon price
- significant support for the requirement for allocation recipients to have decarbonisation plans and for these to be scrutinised
- strong preference for all IA parameters to be looked at together as a package, as well as concern around overlap between these reforms on IA and the ability for the Climate Change Commission to recommend changes to phase-out rates
- some support for greater accountability around IA, as well as concern around the validity that emissions leakage really is a risk.