



Te Arotake Mahere Hokohoko Tukunga

Review of the New Zealand Emissions Trading Scheme

Summary of the consultation



Ministry for the
Environment
Manatū Mō Te Taiao



**MINISTRY OF BUSINESS,
INNOVATION & EMPLOYMENT**
HĪKINA WHAKATUTUKI

Ministry for Primary Industries
Manatū Ahu Matua



Reviewing the New Zealand Emissions Trading Scheme

The Government is inviting public feedback as part of a review of the New Zealand Emissions Trading Scheme (NZ ETS). The review will assess if changes are needed to provide stronger incentives for businesses to transition away from fossil fuels, while also supporting carbon removals.

The effects of climate change are being felt across Aotearoa New Zealand. We need to reduce greenhouse gas emissions from all sectors of the economy. This means:

- ▶ reducing emissions of greenhouse gases from sectors such as transport, waste, energy and agriculture (often called gross emissions)
- ▶ increasing the amount of carbon we remove from the atmosphere, for example, from forest growth.

Cutting our emissions requires a comprehensive and well-balanced mix of policies. Emissions pricing is a critical part of this mix.

The NZ ETS is Aotearoa New Zealand's main emissions pricing tool to reduce emissions. The NZ ETS requires most emitters to report and pay for their greenhouse gas emissions. This enables businesses, households and the public sector to incorporate the costs of emissions – or the benefits of reducing or removing emissions – into day-to-day decisions.

Emissions from all parts of our economy are covered by the NZ ETS except for agriculture. A separate pricing system for agricultural emissions is being developed through the He Waka Eke Noa partnership.

The NZ ETS also rewards activities that remove carbon from the atmosphere, such as forestry. Aotearoa is one of the only countries in the world which does not limit the number of units from carbon removals that can be used by emitters to pay for their emissions.

The difference between net and gross emissions

Our climate change targets are 'net' emissions reduction targets. This means they include the greenhouse gas emissions that are released (gross emissions) and deduct removals of carbon from the atmosphere from activities such as forestry. The Government has committed to prioritising gross emissions reductions, while also supporting carbon removals.



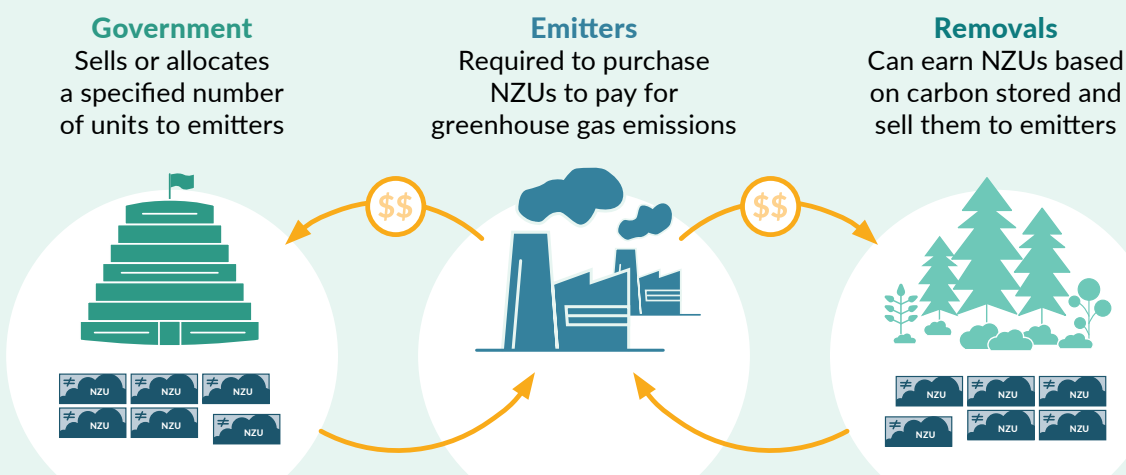
New Zealand Units and the NZ ETS

Businesses in the NZ ETS must report on and pay for their emissions. They do this by surrendering New Zealand Units (NZUs), equivalent to their emissions, to the Government. One NZU is equivalent to one tonne of carbon dioxide equivalent.

NZUs can be purchased from the Government or earned through removing carbon from the atmosphere, for example, through forestry. Industrial allocation also encourages businesses to stay in Aotearoa, rather than relocating to countries where emissions are cheaper or not priced at all. This kind of relocation could also increase global greenhouse gas emissions – this is called emissions leakage.

Individuals and businesses are allowed to trade and purchase NZUs. Expectations of supply and demand for NZUs is a key driver of the NZU price.

Figure 1: How the NZ ETS market operates



The challenge

Aotearoa needs to reduce its emissions to play our part in the global efforts to rein in climate change and reduce our reliance on fossil fuels. A low-emissions economy would offer benefits for New Zealanders, such as warmer, healthier homes, better public transport, new clean-tech industries, and well-paying jobs, especially outside our major cities.

We also need to incentivise forestry and other activities to remove carbon from the atmosphere.

The question is: **Do we want to use the NZ ETS to reduce gross greenhouse gas emissions?**

If the answer is yes, then how can the NZ ETS best support both goals of:

- ▶ reducing emissions of greenhouse gases, and
- ▶ increasing the amount of carbon we remove from the atmosphere?

Why are we considering changing the NZ ETS?

In its current state, the NZ ETS is not driving gross emissions reductions at the scale and pace we want to meet our climate change targets. Currently the price of NZUs means it is cheaper for emitters to pay for their emissions, rather than investing in improving energy efficiency or changing to low-carbon alternatives. There is particular concern that more money is being invested into exotic forestry than improvements in efficiency as NZUs generated from forests are cheaper than the cost of transitioning to low-emissions alternatives.

While we want to incentivise new forest plantings, modelling shows that the NZU supply generated by these forests may exceed the number needed by emitters. If there are too many lower-cost NZUs available for purchase, the price of NZUs will drop. This would weaken incentives for emitters to reduce their emissions. A lower carbon price would also disincentivise new forest planting and could encourage deforestation.

How NZ ETS participants behave depends on what they expect to happen to NZU prices

The NZ ETS is a dynamic market. One of the challenges in accurately predicting the behaviour of NZ ETS participants is that their actions depend not just on today's NZU price but what they expect the NZU price to do in the future. This depends on what they expect other participants to do, because:

- ▶ emitters will invest in low-emissions technology if they expect the price of NZUs to rise and stay high, so that the investment in low-emissions technology is cheaper than paying for NZUs
- ▶ foresters will increase afforestation if they expect the price of NZUs to rise so they can make a profit from selling them in the future, or avoid having to buy more expensive NZUs when cutting their trees down
- ▶ people holding NZUs will continue to hold them if they expect the price to be higher in the future.



Forestry provides a range of benefits

Forestry is one of the most effective tools we have for removing carbon from the atmosphere. Significant new forestry is still needed to meet Aotearoa New Zealand's domestic and international climate change targets and help Aotearoa maintain net zero emissions after 2050.

Exotic and indigenous forests, either permanent or for harvest, provide other benefits, including:

- ▶ employment in rural communities
- ▶ economic returns for land that may otherwise be unproductive
- ▶ erosion control
- ▶ indigenous biodiversity.

We know there can be environmental, social and economic risks associated with forestry and the Government is committed to achieving the right type, location and scale of forests, for the right purpose.

These issues are being considered through changes to the National Environmental Standards for Plantation Forestry and the [consultation on proposals for redesigning the permanent forest category in the NZ ETS](#). The NZ ETS review is considering the type and scale of forestry carbon removals driven by the NZ ETS and the impacts of that scale.

The Ministerial Inquiry into Land Use in Tairāwhiti and Wairoa following cyclone Gabrielle has also recently published its recommendations about the further work needed to address the impacts of land use and storms. The [Inquiry's findings and recommendations](#) were released on 12 May 2023. The Government is considering its response to the Inquiry's recommendations.

Significance for Māori

Māori have significant interests in forestry, native biodiversity and Aotearoa New Zealand's transition to a low-emissions, resilient economy.

The Government has also heard that more urgent climate action is required, with Māori communities particularly vulnerable and already facing the impacts of climate change.

The Government is committed to embedding te Tiriti o Waitangi in Aotearoa New Zealand's climate response.

The impact of changes to the NZ ETS

Changes to the NZ ETS will have an impact on all New Zealanders, in the short and long term.

Focusing on reducing emissions now through the NZ ETS rather than removing them through forestry could be more expensive, at least in the short term. These costs are likely to get passed on to households through higher fuel and electricity prices.

In the long term, New Zealanders will benefit from a low-carbon economy built on efficient, low-carbon technologies.

There is some uncertainty whether reducing emissions now or waiting will be more expensive in the long run. He Pou a Rangi Climate Change Commission considers that prioritising emissions reductions would put Aotearoa in a stronger position to meet and sustain net zero, at lower overall costs to New Zealanders.

We have considered four options

If the Government decides the NZ ETS needs to be changed to provide a stronger incentive for gross emissions reductions, there are four high-level options to do this.

Each high-level option could be implemented in different ways. This will affect the incentive to reduce emissions and increase carbon removal activities.

Option 1

Use existing NZ ETS levers to strengthen incentives for net emissions reductions

The Government could adjust existing regulation in the NZ ETS. For example, it could look at reducing the number of NZUs it sells to decrease the number of NZUs available in the market, so the carbon price rises. This would incentivise polluters to reduce emissions faster, and also incentivise more removal activities.

While this option may provide a short-term increase to NZU prices it will not be effective over the long term. If land owners respond to the increased price by planting more trees, over time, this will supply more NZUs into the market, causing the price to drop. A reduced NZU price would discourage investments in emissions reductions.

Option 2

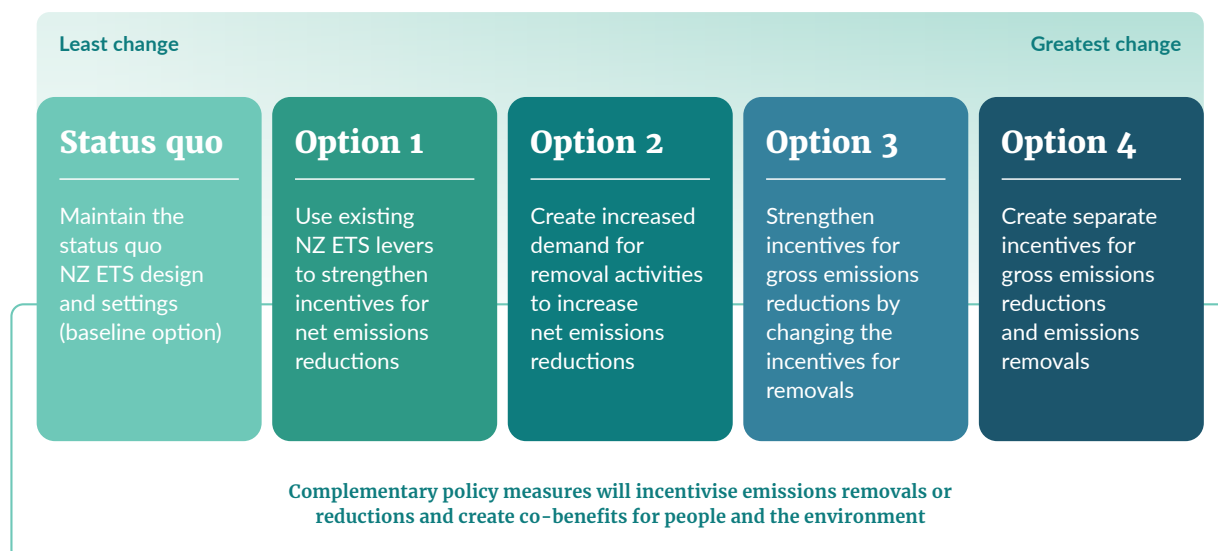
Create increased demand for removal activities to increase net emissions reductions

This option allows the Government and overseas buyers to purchase NZUs from removal activities. This could raise the NZU price if enough additional NZUs are purchased to increase demand, encouraging both emissions reductions and more removals.

However, we anticipate that the effectiveness of this option may be limited as:

- ▶ demand from overseas buyers for NZUs from exotic forestry is unknown, though we anticipate it would be minimal
- ▶ demand created by the Government purchasing NZUs will depend on the amount it is willing to purchase and how much it is willing to pay
- ▶ the Government would need to consider whether money is spent to purchase NZUs or provide funding to help transition infrastructure to lower emitting technologies.

Figure 2: Proposed options to strengthen the incentives for gross emissions reductions in the NZ ETS





Option 3

Strengthen incentives for gross emissions reductions by changing the incentives for removals

The Government could apply restrictions or conditions to NZUs from carbon removals. This would make removal NZUs less attractive and increase the demand for other NZUs sold by the Government at a price that encourages businesses to reduce their emissions.

There are different ways this option could be implemented. For example, the Government could restrict how many forestry generated NZUs emitters can use to 'pay' for their emissions. Or they could reduce the number of NZUs given out for forestry, relative to the amount of carbon removed from the atmosphere.

Applying such restrictions or conditions would likely reduce the value of removal activities, making them less financially attractive. This option would disincentivise carbon removal activities unless the Government provides other incentives for forestry that are outside the NZ ETS.

Option 4

Create separate incentives for gross emissions reductions and emissions removals

This would create two NZ ETS markets with separate prices: one for emissions reductions and another for removals. Emitters would not be able to use forestry NZUs to 'pay' for their emissions. Instead, carbon removals would be sold directly to the Government or on a separate market.

This option allows the Government to incentivise reductions and removals independently towards budgets and targets, and provides the most comprehensive change to the NZ ETS, relative to the other options. Because the Government can now control the cost for businesses to pay for their emissions it can encourage faster decarbonisation.

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We want your views on the New Zealand Emissions Trading Scheme review

Please share your thoughts on the New Zealand Emissions Trading Scheme review. We want to hear from people across Aotearoa – your voice matters.

- ▶ Read the [discussion document](#).
- ▶ Attend one of our webinars or hui. These are listed on [our website](#).
- ▶ Provide a submission through [Citizen Space](#), our consultation hub, by completing the feedback form or by uploading your own written submission.

We request that you don't email or post submissions as this makes analysis more difficult. However, if you need to, please send written submissions to NZ ETS review, Ministry for the Environment, PO Box 10362, Wellington 6143.

If you are emailing your feedback, have pātai (questions), or require additional information, email etsconsultation@mfe.govt.nz.

Submissions are open from 19 June 2023 and close at 11.59pm, 11 August 2023.

What happens next

The review poses a number of questions about the impacts, trade-offs, and risks of changing the NZ ETS to incentivise emissions reductions. Feedback will support officials to provide the incoming government with recommendations on next steps for the NZ ETS review.

The Government will not pursue legislative or regulatory changes before the election.

