



Submission to “Review of the New Zealand Emissions Trading Scheme”

Organisation

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Responses to discussion document questions

Introduction

Firstly, we would like to commend the Ministry for the Environment, the Ministry of Business Innovation and Employment and the Ministry for Primary Industries for their cross-departmental efforts to improving the settings of the Emissions Trading Scheme (ETS) so it can be an effective tool to help meet New Zealand’s emissions goals, while also addressing the wider impacts that these settings can have on issues.

Related to these consultations we recently completed a research report for the Forestry Ministry Advisory Group¹, which showed that at the time the respondent entities were planning to focus on abatement rather than offsetting of emissions. These respondents also expected a higher future price of carbon, which we discuss may be a key driver in their decisions. However, this survey was completed when the NZU price was above \$80 and it

¹ <https://www.mpi.govt.nz/dmsdocument/57409-A-market-survey-to-ascertain-offsetting-demand>



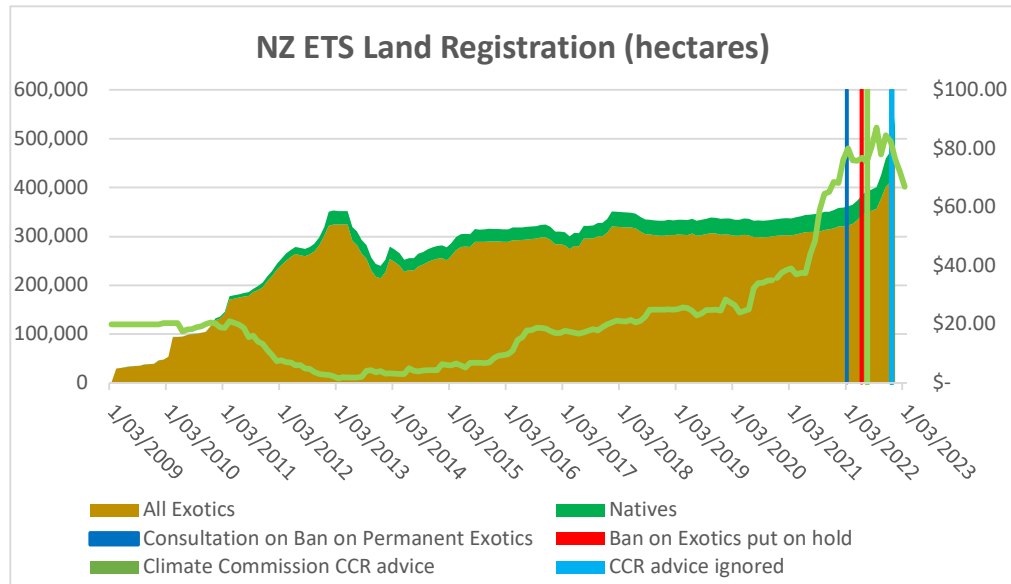
has dropped significantly since. We are concerned about what may be happening to these plans by businesses to reduce gross emissions.

In the governments' own emission reduction plans an increasing price of carbon is a key driver of the effectiveness of the New Zealand ETS, however, many policy decisions and ETS settings do not align with this plan. As it exists right now, it operates as a system for offsetting fossil fuel emissions with commercial pine plantations, which has been described as simply "a licence to pollute". Below we summarise some of the key issues.

- Going against the Climate Change Commission (CCC) advice on the Cost Containment Reserve late last year. This has now been resolved but only due to a successful judicial review arguing that increasing prices of emitting activities cannot be a reason for not improving the ETS and lifting the price ceiling. Hopefully the Government can act more in line with the CCC advice in the future, without the need for judicial reviews which are administratively costly and create uncertainty.
- The consultation document discusses a preferred price pathway, which, in our view, is an ill-conceived proposal. The ETS settings need to focus on emission reductions in terms of the total quantity of emissions while the price of emissions must be set endogenously (within the market). A good example of how this should work is given by New Zealand's Individual Transferable Quota System (ITQs). The Government determines the annual total allowable catch for each fish stock, while trading/leasing of ITQs determines the market price of quotas. The price signals allow for ITQs to be traded to the lowest cost fishers, such that the total allowable catch is caught at least cost to society. By analogy, this is the purpose of having an ETS: it creates efficiency gains relative to a carbon tax and allows for the emission reduction to be achieved at least cost to society. Price signals, as determined by trading permits in the market, is a key features of an efficient ETS.
 - Cost impacts on emitting activities are the whole point of the ETS and any adverse impacts on vulnerable people (not large businesses) should be mitigated with other levers funded by the ETS auction revenue.
- Unlimited Exotic afforestation, which creates an extremely low-cost option for unit generation relative to reduction of gross emissions. New Zealand is the only national or supra-national ETS which allows this level and type of sequestration. This setting is now under review, and we have submitted to that consultation separately. Figure 1 below highlights the issues of exotic forest registrations into the ETS, as at 1st January 2023.
- Industrial allocation misaligns the incentives that the ETS is meant to create. The simplest way to explain this is to ask a question. How can a price on emissions incentivize an emitting entity to reduce emissions, when doing so will mean they receive less free allocation of NZU credits in the future? Essentially, the current settings disincentivise abatement by entities which receive industrial allocation. The recent review does not seem to be addressing this issue and may be escalating it.
- Our agricultural emissions, which make up are a disproportionate excessive source of about half of our country's emissions profile. How can we expect an ETS to be effective when it ignores this key sector? Further, the current proposal of He Waka Eke Noa would create arbitrage opportunities and further perverse incentives that do not align with national objectives.

- Most of the above issues also create an enormous amount of policy uncertainty, with multiple reviews and consultations and consistent changing of the rules. For polluters to invest in new technologies or changing processes, or landowners to plant indigenous forests they need some sense of expectation of what the future ETS settings will look like.

Figure 1: Forest Registrations into the NZ ETS



The Climate and Energy Finance group would appreciate the opportunity to support Government in their decision making, and are more than happy to be contacted for advice in the future.

Below we will more specifically address the concerns raised by the consultation document. However, we want to note that the stated 4 options are only 2 options that are not all that different and none of the proposals fully address all of the issues raised above. Failing to address these issues will result in the cost of offsetting our emissions becoming even larger than anticipated (currently estimates range between 5-30 Billion New Zealand Dollars), not to mention the risks to our trade relationships and, of course, human well-being.

2.1 Do you agree with the assessment of reductions and removals that the NZ ETS is expected to drive in the short, medium and long term?

In general yes, although we have not replicated the findings.

2.2 Do you have any evidence you can share about gross emitter behaviour (sector specific, if possible) in response to NZU prices?



We recently completed some research for the Forestry Ministry Advisory Group², exploring company demand for offsetting and intentions around emission reduction plans. This research showed that entities were planning to decrease emissions, however, they also expected a higher future carbon price. The research also found that respondents value indigenous forest sequestration higher than exotic. Further, we found that the effect on biodiversity, brand value and credibility were more important factors in emission reduction decisions than the cost of the emission reduction.

2.3 Do you have any evidence you can share about land owner and forest investment behaviour in response to NZU prices?

Please see Figure 1 above. We are happy to be contacted and discuss any insights and opinions further.

In many government documents, including the current NZ ETS review document, part of the reasoning for the Māori commercial interest in exotic forestry has been given as follows:

“Around 30 per cent of Aotearoa New Zealand’s 1.7 million hectares of plantation forestry is estimated to be on Māori land. This is expected to grow to 40 per cent as Tiriti settlements are completed.”

However, a recent information request to Te Uru Rākau, the New Zealand Forest Service, resulted in provisions of a dataset showing that post-1989 planted forests on Māori land, that is the forests relevant to the ETS settings, is 47,408 hectares and pre-1989 plantation forests on Māori land make up 153,233ha. Even combined that makes up only 11.8% rather than 30%. Where does the 30% statistic come from, as no report or evidence is ever cited.

Further, Māori are not a homogeneous group and many of us strongly support limiting removals credits to only indigenous forests (for example: <https://manataiao.wordpress.com/recloaking-papatuanuku/>).

Forestry is certainly an important component of the “Māori Economy”, but commercial timber industries should be profitable, without earning carbon credits and the opportunities of carbon farming with indigenous forests is still there even on marginal land. Currently this is not feasible, in part, due to the downward price pressure of the cheaper Pinus Radiata monocrop plantations that the Government has allowed into the Permanent Forest category without much justification.

2.4 Do you agree with the summary of the impacts of exotic afforestation? Why/why not?

We note that while exotic forestry may provide some benefit for erosion control this can only occur if the forest is not harvested and is managed to transition to a diverse native forest ecosystem with long lived canopy trees and diverse abundant ground cover. Exotic forestry monocultures with minimal understorey are not optimal for erosion control.

² <https://www.mpi.govt.nz/dmsdocument/57409/direct>



3.1 Do you agree with the case for driving gross emissions reductions through the NZ ETS? Why/why not? In your answer, please provide information on the costs of emissions reductions.

Yes, this is the reason we designed an ETS in the first place. Forestry and landowners are a crucial part of the ETS, but are certainly not the only one. It is now important to extend the ETS to all relevant market sectors in order to realise the fully efficiency gains of an ETS as outlined above.

“Existing price corridor indicates range that would support reductions in line with emissions budgets and 2050 target”. This is just not true. The Commission’s initial modelling showed carbon values at top end of this required. The Commission’s updated and more detailed analysis in 2022 showed that a higher price corridor is needed. Cabinet’s decision last December not to follow the Commission’s advice on this has caused lasting harm to ETS confidence: the consultation document here seems to be trying to justify Cabinet’s decision rather than reflecting expert advice from the Commission (and even from officials).

“the review explores whether we want to use the NZ ETS to create a preferred price pathway for emitters. If the answer is ‘yes’, the review seeks to identify what this preferred pathway is and how to adjust or redesign the NZ ETS design so it can deliver this price pathway.” The focus should not be on prices but rather primarily be on targets. In an ETS, the focus is on the quantity of emissions. The question as to what the right target for gross emissions reductions is important and has to be addressed incorporating New Zealand’s international obligations and climate change modelling scenarios.

3.2 Do you agree with our assessment of the cost impacts of a higher emissions price? Why/why not?

We believe there will be a cost to households, although this may differ to the estimates in the report. However, the entire purpose of an ETS is to increase the cost of emitting activities in order to drive behaviour change. Given this fact, prices of goods will also increase, creating the incentives the ETS is seeking. To facilitate transition, support for the adoption of low-emission technologies should be provided (see comment below).

3.3 How important do you think it is that we maintain incentives for removals? Why?

Removals incentives are quite unique to New Zealand at this relative magnitude. Removing all incentives will create many negative consequences, while keeping the rules as is will also have many issues as discussed in the document and elsewhere. The ideal approach is to address all issues harming the ETS’ effectiveness (outlined in introduction) for gross emission reduction or emission removals with environmental and human long-term co-benefits. Such an approach is being implemented by the European Union ETS, for example.

That is the incentives can be maintained but should be reserved for the most beneficial forests, which also have a relative cost that would still allow the ETS to incentivize gross emission reductions. These forests are also the most appropriate for establishing a long-term carbon sink.

4.1 Do you agree with the description of the different interests Māori have in the NZ ETS review? Why/why not?



As non-Māori indigenous allied researchers, our opinions on chapter 4 must be taken in such a context and we do not claim to purport the views or interests of Māori.

However, as stated above (question 2.3) we know that the commercial interest in exotic carbon farming is not shared by all Māori. Further, the fact that forestry is a large asset class for Māori Asset owners does not mean that these forests need to be in the permanent forest category. Should timber forestry activities not be feasible/profitable without the additional carbon payments of permanent forests? Further, remote and steep land, which may not be suitable to timer forests, can still be suitable for indigenous afforestation and its associated long-term carbon revenues. This is not the favourable approach when cheaper exotic forests are allowed in the permanent forest category. This is true for Māori and non-Māori foresters.

The current cost differential between establishing native and exotic forests is a strong driver of exotic forestation on Māori-owned land. A Biodiversity Credit Scheme would go a long way to bridging this gap, and University of Otago is preparing a submission on the Biodiversity Credit consultation document currently. Such a scheme is, however, some years away. In the meantime, there is a great danger that current policy incentives are resulting in Māori investing in large scale permanent exotic forests which could very likely become a liability within one generation, leaving these communities with no option for further income generation, as once the land is forested it must remain forested. We strongly recommend that it should be compulsory for permanent exotic forests to be managed to transition into native forests.

5.1 Do you agree with the Government's primary objective for the NZ ETS review to consider whether to prioritise gross emissions reductions in the NZ ETS, while maintaining support for removals? Why/why not?

We believe the intention behind this proposal is better than the priority of net only emissions reductions the ETS settings seem to have been following so far. However, these two priorities cannot be equally important, **reducing gross emissions needs to be the top priority**. Incentivizing only those removals with co-benefits, which do not create new intergenerational risks, should be demoted to the considerations level.

- NZ should not delay our transition to a low-carbon economy and society because we happen to have land suitable for afforestation.
- A failure to reduce emissions now transfers the task of economic transformation to future generations, who will simultaneously be dealing with even greater climate impacts than we are already experiencing today.
- Internationally, other ETS systems focus on driving gross reductions. Any offsetting is only allowed as a token amount.
- Proper alignment with 1.5C means dramatic reductions in fossil fuel emissions.
- The Commission's demonstration path still includes far more forestry offsetting than in global 1.5C-consistent scenarios. This is not a criticism of the Commission, which was constrained by the legislation to provide scenarios that achieve the current 2050 targets. It did not have the mandate to recommend truly 1.5C-consistent pathways.



5.2 Do you agree that the NZ ETS should support more gross emissions reductions by incentivising the uptake of low-emissions technology, energy efficiency measures, and other abatement opportunities as quickly as real-world supply constraints allow? Why/why not?

Yes, this is the entire purpose of the ETS, to meet your emissions reduction plan. Regulating the supply of NZUs in line with New Zealand Nationally Determined Contributions and our climate ambitions and then letting the market determine the price will allow the lowest marginal cost of abatement solutions to be implemented first. The issue currently is that planting exotic, specifically *Pinus radiata*, forests is the cheapest marginal cost way to meet Unit surrender obligations relative to emission abatement but will limit our ability to continue reducing net emissions as current forests reach the end of their useful lives in c. 40 years.

5.3 Do you agree that the NZ ETS should drive levels of emissions removals that are sufficient to help meet Aotearoa New Zealand's climate change goals in the short to medium term and provide a sink for hard-to-abate emissions in the longer term? Why/why not?

As discussed above, for the hard-to-abate emitting activities we need some removals to meet our emissions targets, but this should be achieved through forests which create positive co-benefits rather than forests which create new negative externalities and/or intergenerational risk.

We cannot plant our way out of our emission abatement obligations, however we do need to establish a long-term carbon sink for the second half of this century. There is a great risk that if all available/suitable land is planted in permanent short-lived exotic forests in the next decade, we will have no capacity to establish further forest sinks in the future. Incentivising the transitioning of short-lived forests to long-term carbon sink should be a vital part of the ETS strategy. The establishment of a long-term forest sink should not be dictated by the speed of gross reductions, and the rate of gross reductions should not be slowed by the presence of forestry.

5.4 Do you agree with the primary assessment criteria and key considerations used to assess options in this consultation? Are there any you consider more important and why? Please provide any evidence you have.

The primary criteria of gross emission reductions is the most important aspect to any NZ ETS review and changes to settings. However, the key considerations are all important and should include a consideration on incentivizing emissions removals.

We would order the key considerations in order of priority as follows:

1. Support meeting NDCs.
2. Affects the functionality of the NZ ETS market.
3. Incentivize emissions removals, which create co-benefits.
4. Supports co-benefits.
5. Gives effect to te Tiriti o Waitangi.
6. Manages overall costs to the economy and households.
7. Mitigates distributional impacts.

5.5 Are there any additional criteria or considerations that should be taken into account?

We suggest that the ETS should function to reduce gross emissions of the entire economy, not the just under half of our national emissions it currently addresses.

6.1 – 6.6

We will first explain our views on each of the options before suggestion a simple approach to getting the ETS back on track. Overall, it seems there are four options put fourth, 2 of which are infeasible and the last two are quite similar in terms of the incentives they create.

The main issue is not the specifics of the ETS settings which could evolve it to be an effective tool, but rather that there will be an increase of some costs and decrease in some business activities profitability. It will take long-term thinking and some real political willpower if we are going to make the long-term decisions New Zealand needs.

Option 1 is not really a change at all, and we believe most of the consultation outlines why it is not really a viable option if we want an effective New Zealand ETS and to address the concerns raised in the consultation document.

Option 2 is also not really a viable option, as the summary itself states “There is currently no evidence of significant demand from offshore buyers because the removals they would be purchasing would still count towards Aotearoa New Zealand’s NDC.”

Option 3 will create even more complexity and uncertainty for the ETS, it is time we start moving toward simplicity. If the government has not been able to adjust the permanent forest category to an appropriate place until now, how will creating other types of restrictions be done in a sufficient manner. Further, what is the purpose on consulting on the permanent forest category if this option is chosen? One restriction we support would be the units obtained during the Kyoto Protocol period, as a lot of the imported units at the time were of extremely poor quality and low cost.

Option 4 if the removal credits in this separated scheme cannot be used to meet surrender obligations, why would anyone buy them? This is an important question and it seems again an overcomplication to get around the fact that you cannot have an ETS that reduces gross emissions reductions while incentivizing cheap exotic carbon removals.

We believe there are a few important and effective changes that need to be made to the ETS, which would go towards addressing the issues in the ETS, by resolving the issues rather than trying to circumvent them.

1. Remove exotics from the permanent forest category. We could allow for transition forests, but all risk must be born by the forest owner not future generations, that is credits are held in escrow until transition is achieved.
 - a. This would incentivise forest managers to actually achieve this transition.
 - b. It would further still incentivize those forests with co-benefits and which do not create new risks and negative externalities.
 - c. See our submission to the concurrent consultation for more details.
2. Remove industrial allocation altogether and instead opt for accompanying policies to address potential carbon leakage issues.



- a. Auction permits to the highest bidders. New Zealand has seen good results with auctioning broadband spectrum licences in the past, generating substantial government revenues.
- 3. Align auction volumes with NDCs and ERPs
- 4. Integrate agricultural emissions into the ETS to avoid arbitrage and more unintended outcomes.
 - a. Incentivize new technologies, farming practices through subsidies
- 5. Address cost of living issues with a carbon dividend or similar support payments, from ETS revenues, for the people experiencing this, not the industries we are trying to transition/phase out.

7.1 Should the incentives in the NZ ETS be changed to prioritise removals with environmental co-benefits such as indigenous afforestation? Why/Why not?

Only removals which create co-benefits **and** avoid negative externalities should be considered for removal credits. We need to move beyond carbon only to an integrated approach when considering these policy levers.

7.2 If the NZ ETS is used to support wider co-benefits, which of the options outlined in chapter 6 do you think would provide the greatest opportunity to achieve this?

As discussed above, neither of the two options (3 and 4) really provide what the ETS review is trying to achieve.

We should try to properly reward non-carbon benefits so that indigenous forests would be able to compete, it is not a question of prioritising these over carbon removals.

7.3 Should a wider range of removals be included in the NZ ETS? Why/Why not?

Not until all emissions are included and industrial allocation is abolished.

7.4 What other mechanisms do you consider could be effective in rewarding co-benefits or recognising other sources of removals? Why?

Biodiversity credits have some potential and we are currently in the process of formulating a submission on the government's proposed biodiversity credit system.