

21 January 2020

Submission on the Climate Change Response (Emissions Trading Reform) Amendment Bill
Environment Committee
Parliament
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PEPANZ Submission: Climate Change Response (Emissions Trading Reform) Amendment Bill

Introduction

1. The Petroleum Exploration and Production Association of New Zealand ("PEPANZ") represents private sector companies holding petroleum exploration and mining permits, service companies and individuals working in the industry.
2. This document constitutes PEPANZ's submission to the Environment Committee on the Climate Change Response (Emissions Trading Reform) Amendment Bill. We wish to be heard by the select committee.

Scene-setting

3. A sound Emissions Trading Scheme ("ETS") should be internationally connected to enable lowest marginal cost abatement, and carbon prices should be comparable to those in jurisdictions against which domestic firms compete in order to maintain their competitiveness and to minimise risks of carbon leakage. Free allocation is an important tool to manage prices, and other mechanisms to manage price are important providing they are underpinned by stable settings.

Policy process and the need for predictability

4. The Zero Carbon Bill and the Ministry for the Environment's consultation document on "Improvements to the New Zealand Emissions Trading Scheme"¹ (which preceded the introduction of this Bill) went through reasonable policy processes which we supported. However, we are concerned that the recent launch of concurrent policy proposals will compromise policy coherence and coordination which in turn creates unpredictability and reduces confidence that reasonable assumptions about the future are broadly likely to hold.
5. The ETS is now an integral institution in the New Zealand economy and economic well-being will suffer if policy is not well-considered. Emissions markets are artificially created, which means that participants are concerned not only with the dynamics in the market itself, but also with the stability of framework of the created market and the approach of market-regulators.
6. We note that current and recent emissions policy includes consultation on the:
 - a) Climate Change Response (Emissions Trading Reform) Amendment Bill;
 - b) "New Zealand Emissions Trading Scheme: Modelling the electricity allocation factor: Issues paper"²;
 - c) "Reforming the New Zealand Emissions Trading Scheme: Proposed settings"³; and

¹ <https://www.mfe.govt.nz/publications/climate-change/improvements-new-zealand-emissions-trading-scheme>

² <https://www.mfe.govt.nz/publications/climate-change/new-zealand-emissions-trading-scheme-modelling-electricity-allocation>

³ <https://www.mfe.govt.nz/sites/default/files/media/Climate%20Change/reforming-the-ets-proposed-settings-consultation.pdf>

d) "Reforming the New Zealand Emissions Trading Scheme: Rules for auctioning technical consultation document"⁴.

7. In addition, we now understand that in late 2019 Cabinet agreed to a two-year review of the industrial allocation regime.
8. With all of this policy development work underway including now a *new* review of industrial allocation commencing (with undisclosed terms of reference and scope), it becomes difficult to engage with the current bill's proposals in relation to effective allocation methods. A holistic approach to emissions policy is important for both Government and the commercial sector alike, and new unexpected workstreams lead to uncertainty about the medium-term future of the allocation regime.

International units

9. Our view is that a fundamental reason to use an Emissions Trading Scheme, (compared to a carbon tax) is that it enables international trading to achieve emission reductions at the lowest marginal cost. To realise that goal, it is essential that international units can be used (and clearly they must be genuine and of high integrity). Without international trading, New Zealand is not utilising the full benefits of an ETS.
10. There seems to be some concern that international units mean no domestic reductions will be made, but we do not consider that anticipation to be accurate. Firms will look for domestic abatement opportunities in their business and then to domestic credits, so international units will only be used when cheaper domestic opportunities are not available. They therefore serve as important pressure release valve – a concept the Government is in fact championing through the Cost Containment Reserve.
11. The 'Zero Carbon Act'⁵ includes in section 5Z a strong presumption against international units (which it refers to as 'offshore mitigation'), and we remain concerned about the negative implications of this policy. Without access to international units there will likely be inefficient allocation of resources. In the absence of international credits, ambitious emission reductions will weaken New Zealand firms by imposing higher costs than those faced by trade-competitors.

Phase-down of industrial units

12. Amending the regime for free allocation must be done with extreme caution as it dampens the desire to take early action. This is a well-known phenomenon as countries face this very risk at the international level with the negotiation of more stringent national emissions reduction targets and the ability to capture the advantages of acting now. If the 'baseline' keeps changing then Governments cannot reap the benefits of earlier action. Similarly, businesses cannot invest in emission reductions with certainty because the allocation regime underpins the investment decision. This can lead to near term opportunities being deferred as firms await greater predictability.

Allocation should be in line with trade-competitors

13. Amendments to the free allocation regime should not unduly compromise the reasonable rights of emitting entities which existed before they entered the ETS. In practice, the free allocation of units is crucial to ensure that firms face similar costs to international competitors and this is important so to not impair their assets. Emissions pricing is about sending signals at the margin which encourages consideration of emissions and direction of travel towards a low net emissions future (this happens even with free allocation).
14. If we are conscious of undesirable price blow-outs (as the Government is rightly concerned about, as indicated by its consideration of the Cost Containment Reserve), then we should also ensure that industrial allocation is not phased down faster than firms in competing countries.
15. Conceptually, any removal of free allocation should be in line with relevant international developments among trade competitors rather than any arbitrary timelines or pre-determined percentages. Free allocation should only be reduced when the international conditions are such that carbon leakage from New Zealand is no longer a material risk. The rate at which carbon leakage risk declines will be determined by dynamic global factors and so free allocation to trade-exposed industries in New Zealand should remain appropriately benchmarked.
16. In reality however, it is difficult to judge at this time how global policy settings will evolve over coming years and we are mindful that previous expectations of international policy development in the emissions trading

⁴ <https://www.mfe.govt.nz/publications/climate-change/reforming-new-zealand-emissions-trading-scheme-rules-auctioning>

⁵ Climate Change Response (Zero Carbon) Amendment Act 2019.

area have not been realised. We therefore agree that a 0.01 default phase-out rate is appropriate as a starting base until 2030. However, we do not support the 0.02 and 0.03 reductions in the subsequent decades due to the new review of free allocation which Cabinet agreed to just before Christmas 2019. Until that review is complete, it is inappropriate to lock in further reductions.

Regulated phase-out should not be unidirectional

17. New Section 84B in the bill provides for regulations increasing the phase-out rate for specific activities. If factors have changed, regulations should not only provide for a hastened phase-out but should also allow for increased industrial allocation. There is no good public policy reason why this should be unidirectional.

Procedure for regulations setting phase-out rates

18. The criteria for regulating phase-out rates do not adequately focus on what we consider to be the most fundamental reason for free allocation, which is minimising the risk of carbon leakage.
19. In addition, new section 84C(3)(b) relates to nationally determined contributions under the Paris Agreement, but this could be captured under new section 84C(3)(g), which relates to international climate change obligations. New section 84C(3)(b) could therefore potentially be deleted as redundant and to avoid duplicative consideration of the same factor.
20. It is unclear how new section 84C(3)(e), which relates to “other sources of supply into the emissions trading scheme, including offshore emissions reductions”, is relevant to assessing international competitiveness. The units must still be purchased, regardless of their origin, so it still represents a cost. If industrial allocation is about ensuring trade-exposed firms remain competitive (as we submit) then the cost of units to the firm should be the key consideration.
21. It is unclear to us how new section 84C(3)(e) (which relates to the cost to taxpayers) is relevant to managing carbon leakage.
22. New section 84C(3)(f), which relates to the availability of low-emission technologies related to the activity, should be amended to refer to the “commercial availability” to ensure that only practicable technology is considered.
23. A new criterion which considers the benefit to the New Zealand economy and society arising from free allocations should be included.
24. It may be appropriate to have some weighting or priorities set in relation to the criteria in new section 84C(3).

Cost containment reserve

25. We support the development of a cost containment reserve, but the design detail will be crucial and the relevant regulations must go through a robust policy process. Any such scheme risks becoming dysfunctional in the absence of international units, as foresters may be incentivised to hold units so the price falls just below the level of the trigger point. Prices are already substantially above the marginal cost of new forestry, so now it seems to be a matter of discovering the lessor of the price of abatement or cessation of production. In the absence of commercially-available abatement technology, the choices available to emitters are stark.
26. In relation to the Ministry for the Environment’s *Proposed Settings Consultation Document*⁶, it is difficult to obtain sufficient clarity on whether units auctioned under the cost-containment reserve as in addition to the cap and carbon budgets or whether a sum within that budget is reserved for use if needed.
27. Finally, new section 30GC(5)(e) has reference to “... including any desirable carbon price (if available)”. We are concerned about this, as it is akin to asking the Reserve Bank to forecast exchange rates or asking the Electricity Authority to forecast electricity prices. Carbon prices are discovered by the interaction of a complex mix of unit demand and supply factors and regulators should avoid issuing market sensitive price information, as market participants will rely on it rather than the actual market outcomes.

Publication of individual emissions data

28. We do not consider there are sound public policy reasons for publishing individual emissions data reported by NZ ETS participants. The key question is whether regulators are getting sufficient and appropriate emission data to promote the efficient functioning of the scheme, and we contend that they already are. The desire to publicise details about individual entities therefore seems gratuitous and appears to be driven by a

⁶ <https://www.mfe.govt.nz/publications/climate-change/reforming-new-zealand-emissions-trading-scheme-proposed-settings>

desire to 'name and shame' emitters. We note our calculation from the Greenhouse Gas Inventory that direct emissions from the entire upstream petroleum sector contributes approximately 1% of New Zealand's greenhouse gases.