SUBMISSION

Submission from Straterra
to the Ministry for the Environment
Proposed Changes to the ETS
October 2022

Introduction

1. Straterra is the industry association representing the New Zealand minerals and mining sector (including coal). Our membership is comprised of mining companies, explorers, researchers, service providers, and support companies.

2. We welcome the opportunity to make this brief submission on the Government's proposals for the Emissions Trading Scheme (ETS) as set out in the consultation document, Proposed changes to New Zealand Emissions Trading Scheme limit and price control settings for units 2022 (the document).

Straterra position

3. Straterra supports the Government's steps for New Zealand to meet its obligations under the 2015 Paris Agreement. Our key concern is that policies do not simply cause carbon leakage ie transfer emissions, along with business activity, offshore, not benefiting the world climate but risking economic harm to New Zealand. Integral to this is maintaining the international competitiveness of affected sectors.

4. Allowed to work properly, emissions pricing is the least-cost way of reducing emissions. But we do not support the complementary policies outlined in the Emissions Reduction Plan or ongoing changes to the ETS settings, such as the ones in the document.

Summary

5. We do not support the proposed changes to the settings as outlined in the document, the reasons for which are outlined in this submission. Instead, we support the **status quo** for each of the settings considered:

   - ETS limits
   - Cost containment reserve structure – two tiers
   - Cost containment reserve volumes
   - Cost containment reserve trigger prices
   - Auction reserve

6. Continued tinkering on the ETS settings is creating major uncertainty. The higher prices likely to result under the Climate Change Commission's proposals, come at a time of high inflation and are

likely to lead to significant business closures with emissions transferring offshore. Stable and predictable ETS settings are needed.

7. We elaborate on each of the proposals in this submission but first discuss some important context that is not given due attention in the document.

Context

Inflation and the energy crisis

8. Most of the proposals in the document pave the way for significantly higher NZU prices – much higher than market participants and businesses generally anticipate under the existing settings. These are likely to feed into higher prices generally throughout the economy largely through higher energy costs. This comes at a time of a high inflationary environment in New Zealand and around the world and an energy crisis triggered largely by the Russia-Ukraine War.

9. The Climate Change Response Act 2002 says both inflationary impact and impact on households and the economy have to be taken into account when considering NZU limits and price control settings.

10. The falling NZ dollar, at its lowest level for 13 years on a trade-weighted basis, is also relevant, given the overseas factors contributing to New Zealand inflation. The flow on effects through the economy would result in spiraling inflation and corresponding higher interest rates.

11. Tables 20 and 21 on pages 38 and 39 are useful to gauge the impact of the NZU price on energy prices. As stated above, these direct impacts are likely to feed into higher prices generally.

12. Table 21 shows that petrol prices, for example, could increase significantly next year if the commission's proposals proceed, steadily increasing to 2027.

13. This petrol price rise will be exacerbated when the 25c/litre fuel excise tax removal, implemented in response to the Russia-Ukraine war, is reversed - currently scheduled for 31 January 2023.

14. On that note, we think it is disingenuous for the Government to curtail fuel price rises caused by the war with one hand and then allow a government-driven boost in fuel prices with the other hand through the ETS settings.

15. People would still buy petrol, while other activities have a heightened risk of closure because they will be non-viable, especially activities that must be internationally competitive to continue.

Carbon leakage

16. The extent of the price rises relative to the existing track would be significantly disruptive, contribute to major uncertainty, and likely to lead to both significant business closure and mass afforestation of radiata pine.

17. It is notable that the document acknowledges this. On page 40 it says:

> *"If prices rose to reach the Commission's recommended CCR trigger prices, this price rise, in combination with the phase-out of industrial allocation, might have the impact of closing down firms in some industries in New Zealand unless they rapidly decarbonise."*

18. Given the inability for such rapid decarbonisation to occur, this statement cannot be emphasised enough, as a rationale for maintaining status quo ETS settings. If the proposals go ahead, the Government will have to manage the risk of a major adverse consequence for the New Zealand economy.

Comments on specific proposals

ETS limits

19. We do not support the proposed reduction in units available for auction.

20. What is proposed in the first year alone is a reduction from 18.6 million units in 2023 to 15.6 million in 2024 compared with the existing trajectory of 18 million in 2024.

21. This will have a major upward impact on price and squeeze emitting businesses to such an extent that carbon leakage is likely.

22. The greater part of the proposed reduction is driven by adjusting for the **stockpile** and reducing the number of units issued at auction accordingly. This is unjustified on a number of grounds, and it is bad policy to tinker with the rules in this way.

23. As the document says on page 19, all emissions trading schemes around the world allow 'banking' of units and there are good reasons for allowing it, namely it helps reduce price volatility, ensures the NZU price is forward-looking and supports participants to manage their future liabilities.

24. There seems to be an assumption that withholding NZUs from auctions would result in units being made available on the secondary market, but this will not necessarily be the case.

25. Lowering the supply of units at auction will not necessarily make those holders of banked units use or release them. All it will do is reduce availability for participants and cause the price to rise. The consequences will be dire for many businesses if the banked units are not released and if there is a shortfall of units.

26. We also disagree with the Climate Change Commission (the Commission) that increases in emissions from non-NZETS sectors should translate to a reduction in allowable emissions from NZETS sectors. While we understand the need to contain total emissions, it is inappropriate to allow one group to squeeze the rest in this way.

Cost Containment Reserve structure – two tiers

27. We do not support the Climate Change Commission's proposal to introduce two tiers for the Cost Containment Reserve (CCR).

28. The analysis in Table 16 on page 34 of the consultation document does not provide good reasons for doing so. The only argument provided in support is that it "reduces the risk of slowing stockpile drawdown". As stated earlier in this submission, we do not agree with the Government's rationale for stockpile drawdown. We agree with the comment in the table about the additional complexity it will introduce.

Cost Containment Reserve volumes

29. The CCR's purpose is to release additional units beyond a specified threshold to stabilise prices. We support the current reserve volume of units and we do not support the Commission's proposal to reduce it.

30. One possibility in the future would be for international units, once they are available, to be among the units introduced as part of the cost containment reserve. It goes without saying that all such overseas units would have to be verified and have environmental integrity. It also goes without saying that New Zealand access to these units currently does not exist, and may never exist.

Cost Containment Reserve trigger prices

31. The CCR trigger price is deemed to be "the upper extreme of acceptable prices in the New Zealand ETS" and can be seen as a defacto cap. The Commission's proposed increases to the trigger price are excessive (from $78.4 to $171/$214 (Tier 1/Tier 2) in 2023, increasing to $214/$268 in 2027).

32. The proposed increases make a mockery of the trajectory that was established just last year, $70 in 2022 moving to $110.15 in 2026. Such changes create uncertainty which impacts businesses willingness to invest in reducing emissions.

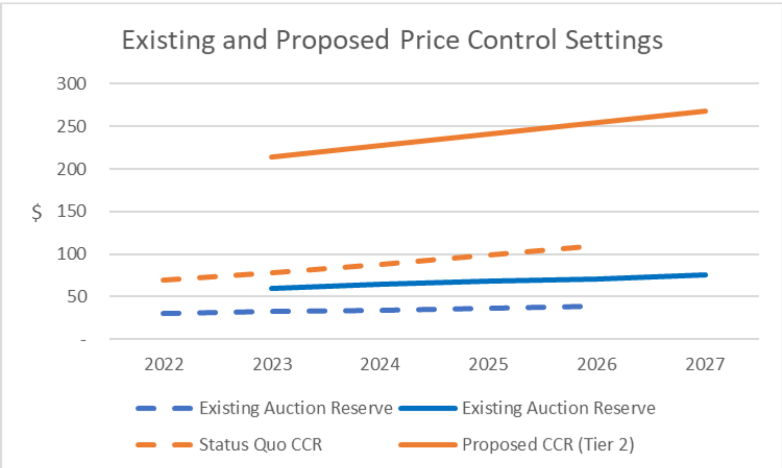
33. In addition to the extent of the change and the uncertainty caused, the levels of the trigger prices themselves are so high they would result in carbon leakage and business closures if the NZU Price reached them.

34. For example, the price could increase from $70 to $214 (the Commission's Tier 2 trigger for 2023) in one hit. Based on the figures in the table on pages 38 /39, this $144 increase would increase petrol prices by 36.5c/litre and residential electricity prices by as much as 5.17 c/kWh.

Auction reserve

35. As with the proposed increase in the CCR trigger prices, the increase in the auction reserve price proposed by the Commission is too great. The Commission's 2021 recommendations were an increase from $30 in 2022 to $39.32 in 2026. The latest recommendation has it rising to $75 in 2027.

36. The graph below plots the current and proposed trajectory for both the auction floor and the CCR trigger price (Tier 2). It shows the extent of the increase, particularly for the CCR and how the proposed range between the upper and lower limits would widen.



Other points

International units

37. As the document says, agreements for the import of approved overseas units have not been reached so there is no allowance for these.

38. We make the point that climate change mitigation requires a global approach i.e. a reduction in global emissions. Allowing the purchase of legitimate overseas units with high environmental integrity allows emission reductions to occur where abatement costs are the lowest and so we urge the Government to press ahead with discussions with overseas counterparts to enable international units to be included.

39. The carbon price faced by New Zealand emitters, and the stringency of other policies to reduce emissions, need to parallel those faced by our international trade competitors and partners as much as possible, so we can remain competitive and emissions leakage does not result.

40. We note that pricing schemes only cover 23% of global emissions (Source: The Economist, 23 July 2022) and that the average unit price, depending on how it is measured, is less than $6 compared with New Zealand's of around $80.

The ERP working counter to the ETS

41. The Emissions Reduction Plan has introduced a number of actions in addition to the ETS. In our view these are not necessary given the scheme's sinking lid on NZU supply. These actions are not reducing emissions, which are set by the budgets, but instead they are contributing to a NZU price lower than it would otherwise be for a given amount of reductions.

42. The measures proposed in the document are likely to raise the ETS price further which is counter to the impact of the measures in the ERP. We contend the ETS should be left to its devices, that many of the initiatives in the ERP should be abandoned, and the tinkering to the ETS settings, as proposed in this document, should cease.

Gross vs net emissions / forestry offsets

43. It seems that the Commission has a view that forestry offsets are playing too big a role in the path to net zero and it wants to change the rules to put more of a focus on gross emissions.

44. In terms of the current consultation on settings, this shouldn't be allowed to influence the limits ie the level of supply of government units in the auction.

45. The higher NZU prices that are likely to arise as a result of the proposals in this document are so significant, they are likely to lead not only significant carbon leakage and business closure but also mass afforestation.