STRATERRA™
NATURAL RESOURCES OF NEW ZEALAND

Submission from Straterra
To the Ministry for the Environment
Reforming Industrial Allocation
September 2021

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. The sector is proud to be part of the solution to climate change. The products of mining will play an important role in reducing global emissions.

3. We welcome the opportunity to submit on the document *Reforming Industrial Allocation in the New Zealand Emissions Trading Scheme*.

4. Straterra supports the international imperative to reduce carbon dioxide emissions and New Zealand's obligations under the 2015 Paris Agreement. Our key concern is that, in reducing our emissions, it is a loss for New Zealand, and for global emissions, if our policies simply result in those emissions shifting overseas (carbon leakage). Integral to this issue, we seek to maintain the international competitiveness of affected sectors of our economy. In this regard we note the large disparity between the New Zealand and global carbon prices.

Key Submission Point

- In reforming the NZETS, the international carbon price should be a key consideration. It is counterproductive to consider New Zealand's emissions reduction strategies in isolation of the strategies of other nations, particularly our trading partners.

Submission points in relation to the proposed reforms

- If the baselines are to be updated, every ten years is better than every year.
- In terms of eligibility to the scheme, we do not support tightening the emissions intensity thresholds nor narrowing the definition of trade exposed.
- Neither should the scheme be closed to new activities or industries.
- We agree there is a need for better data to improve the government's ability to monitor Industrial Allocation (IA) policy.
- We are opposed to carbon price border mechanisms in New Zealand as well as offshore.
- We do not support direct payments to industry.

General Comments

5. Reducing the risk of the NZETS driving emissions overseas was the rationale for introducing the IA scheme, a goal we fully support. However, in our view, the fact that the ETS doesn't incorporate international trading or take account of the international carbon price is a major reason for this leakage. Rather than using IA to address flaws of the ETS, we propose a first-principles approach and a reform of the ETS itself.

6. Having said that, as it is the IA scheme that is the subject of this review and not the ETS, we argue that eligibility to IA and volumes allocated should be reformed to take account of the high carbon price New Zealand businesses face relative to our trade partners.

7. We are pleased the document acknowledges that there is still a risk of carbon leakage and that remedial measures are justified and that "many of our trading partners and competitors do not have emissions pricing comparable to the ETS".

8. The risk of carbon leakage is increasing as the gap between New Zealand's rising carbon price and prices faced by our trade competitors remains high. If New Zealand's carbon price continues to rise faster than our trade competitors', many emitting businesses will shift their operations overseas or alternatively reduce activity allowing overseas competitors to step in. Either way, local job losses will result, the carbon emitting activity will shift offshore and, typically, global emissions will increase.

9. Unless other jurisdictions keep up, which they are not as a general rule, the rationale for Industrial Allocation in New Zealand becomes stronger not weaker.

10. NZU prices have increased greatly since the commencement of the scheme, and they have more than doubled in the last two years. The recent lifting of the floor and ceiling (to $30 and $70 respectively) and restrictions on volumes under successive emissions budgets mean this price increase is likely to continue.

11. Meanwhile prices faced by our trade partners, while increasing in many cases, are much lower overall.

12. The World Bank's State and trends of carbon pricing, May 2021, implies that less than 22% of global emissions face any carbon pricing, and of this group, the average is USD$6 per tonne of CO2 equivalent.

13. There is an underlying theme in the consultation document that the scheme is too generous to New Zealand emitters, but the carbon price discrepancy argues strongly that this is not the case.

Specific Comments on the Proposals

Section 3 – Options to Reform Allocation Calculations

Updating Allocative Baselines

14. We understand the desire to update the allocative baselines given they are now out of date to the extent that some businesses are making a profit from sales of surplus NZUs. However, if the baselines are higher than current emissions intensities, it is because businesses themselves have improved their emissions intensity over time, which supports the government's climate change mitigation objectives. The IA scheme has been a contributor to this improvement given the incentive it gives businesses to become less emissions intensive than the benchmark (by being able to sell surplus units above the intended level).

15. If the baselines are to be updated, it is important not to lose this incentive which would occur if the baseline were regularly decreased. If the baselines are to be updated, it should be at the slower end of the proposed scale i.e. every ten years as opposed to every year.

16. As well as the efficiency incentive, this longer time frame would provide business with more certainty around their future allocation.

Section 4 - Options to Reform Eligibility for Industrial Allocation

17. Notwithstanding our general comments earlier, we support the focus of the IA scheme on emissions-intensive, trade exposed industries. We disagree with the premise of this section that eligibility for the scheme is too open. If anything, the opposite is true.

Intensity Thresholds

18. We totally oppose raising the intensity thresholds as a tool to limit eligibility and reduce over-allocation or allocation generally. Making it harder for companies to achieve these thresholds is a blunt approach and would undermine the purpose of the IA scheme which is to stop leakage of emissions-intensive, trade-exposed activities. It is far removed from the principles espoused in this submission about international competitiveness being an important consideration. If anything, the thresholds should be lowered.

The Trade Exposure Test

19. Consistent with our argument of the importance of international competitiveness, we support the focus of the IA scheme on trade-exposed industries and we do not support narrowing the definition of trade exposed along the lines proposed.

20. The definition of trade exposed under the Climate Change Response Act 2002, is consistent with economic definitions of the tradable goods and services sector, and while broad, it is appropriate for the purposes of Industrial Allocation.

21. Activities can be considered trade exposed if import substitution or exports are economically viable. The definition shouldn't be limited to what is actually being exported or imported. Importantly goods and services that face competition from imports e.g. domestically produced steel, are trade exposed as much as exported goods that face competition in overseas markets.

Section 5 – Other Options to Reform Industrial Allocation

Setting limits on new activities seeking eligibility for industrial allocation

22. The IA scheme should not be closed to new activities or industries that arrive on the scene. The carbon leakage principle – that if they don't operate here they will simply establish themselves somewhere else in the world – supports this. New Zealand-based activities that emit are often less emissions intensive than overseas counterparts due to our low emissions electricity and relatively high efficiency.

23. The rising carbon price from the New Zealand ETS is already acting as a barrier to new emissions intensive activities, so it is likely that new activities will be few and far between, but it would be foolish in terms of New Zealand's economic management to close down opportunities for new economic activity.

24. We support the idea of providing access to the IA scheme for those businesses that can prove environmental benefit where it broadens access.

Reporting emissions, production and revenue data

25. On the question of voluntary or mandatory reporting of activity data by firms receiving allocations, we accept there is a need for better data to improve the government's ability to monitor IA policy in future.

26. Such reporting would need to encompass all companies or none so in general we don't support moving to voluntary reporting. However, if mandatory reporting is introduced there could be a threshold for very small businesses due to the compliance costs mandatory reporting would impose on very small businesses.

Section 6 – Alternative Policies

Carbon Price border mechanisms

27. We are opposed to carbon price border mechanisms in New Zealand as well as offshore.

28. Such mechanisms might offer local producers some protection from import competition but they would not have any positive impact on exports from New Zealand of emissions intensive goods. In fact, these exports would be disadvantaged greatly if the practice of carbon border adjustment mechanisms was adopted by our trade partners. As an export-dependent country, we must keep away from these instruments and argue vociferously against them in overseas forums.

29. We acknowledge other jurisdictions, such as the EU, are considering some form of carbon border charge to be applied to imported products. New Zealand's a relatively strong climate change regime would make us less vulnerable than many others, but New Zealand would not benefit from retaliation and is in no position to do so.

30. New Zealand introducing such measures would be a departure from our international trade policy which promotes liberalisation. It is difficult to imagine that the government would seriously entertain adopting a border carbon charge.

Direct payments to industry

31. This option proposes decoupling the level of assistance from NZUs and be based on an estimate of the payment needed to keep the industry in New Zealand.

32. We are opposed to this option. It would become too easy to politicise and beneficiaries would lose their social licence.

33. Even if such payments were legal under the WTO, they would contradict New Zealand spirit of free trade and undermine our position in criticising other countries that subsidise industries with which we compete for example, European agriculture and food production and exports.

Using industrial allocation to support emissions reduction

34. This section of the document asks whether explicitly promoting reductions in emissions should be part of IA policy. It overlooks the existing incentive of the scheme that does just this, see paras 14-16 above, whereby businesses are rewarded for emission reductions made from a baseline with income that can be used to invest in further emissions efficiencies keeping firms on a path to continual investment into lower emission ways of operating.

35. Attempt to get the IA to do more to reduce emissions would undermine its role in preventing carbon leakage.

Bringing international carbon prices into the mix

36. As discussed in the general comments and elsewhere in the document, we think it is a major oversight that the discussion on future industrial allocation policy does not traverse the issue of international competitiveness and we think it needs consideration.

37. This isn't one of the options put up for discussion in the document, and we think it should be.