Emissions Trading Scheme Review 2015/16: Priority Issues

Submission to the Minister for Climate Change Issues

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Te Kaitiaki Taiao a Te Whare Pāremata

Contents

Introduction

I appreciate the opportunity to make a submission on the review of the Emissions Trading Scheme (ETS). It has long been my view that climate change is by far the most important and challenging environmental issue that we face.

Putting a price on greenhouse gas emissions – carbon pricing – is essential if emissions of carbon dioxide and other greenhouse gases are to be reduced. In the ETS, New Zealand has developed a good framework for carbon pricing, but thus far it has been little more than a framework. So it is encouraging to see proposals to strengthen it coming forward.

There are two sections in this submission.

- The first is focused on the importance of seeing beyond the next emission reduction target to the long-term goal of a low-carbon economy.
- The second is concerned with the rate of transition toward a low-carbon economy The issues covered in the discussion document relate to this rate of transition, since each deals with an aspect of phasing out the protection of businesses and consumers from the full impact of carbon pricing.

Keeping our eyes on the long-term goal

Over recent years, New Zealand has developed a sequence of targets for reducing our greenhouse gas emissions.

- A target for 2012, following the commitment made at Kyoto in 1997.
- A target for 2020, following the commitment made at Copenhagen in 2009.
- A target for 2030, tabled as our 'intended contribution' at Paris in 2015.

Late last year at the Paris conference, almost all the countries in the world (including China and the United States) committed to taking action to limit the warming of the atmosphere to 2 degrees C. To achieve this goal, the world must essentially stop emitting greenhouse gases altogether before the end of the century. And to play our part, we need to think about how we will do it.

The Government acknowledged the need to look decades ahead when it set the '-50 by 50' target in 2011 – a 50% reduction in the country's 1990 greenhouse gas emissions by 2050.

So while meeting short-term targets is important, it is more important to keep our eyes on the long-term goal – to map out a pathway toward a low-carbon economy. We cannot design such a pathway in detail because we cannot predict how technologies and society will evolve. What we can do is seek the answers to some key questions – answers that are needed for developing policies that will be effective.

Such questions would include the following:

- Where are the opportunities and risks that different industries will face in a carbonconstrained world?
- How much can we rely on purchasing carbon credits offshore? And how can we ensure such carbon credits represent real reductions in greenhouse gas emissions?
- How much would carbon dioxide emissions be reduced by the widespread adoption of electric cars? What are the barriers to widespread adoption?
- How can the Government's goal of 90% 'renewable' electricity by 2025 be achieved? How much would photovoltaic cells help and at what cost?
- What are we going to do about agriculture? How much does methane matter?

Phasing out protective settings in the ETS - the rate of transition

The discussion document does not address these long-term 'big picture' issues, but rather is focused on a number of technical settings of the Emissions Trading Scheme. These settings were put in place to protect businesses and consumers from paying the full costof greenhouse gas emissions and allow time for adjustment. They include the two-for-one surrender obligation and the price ceiling of $25 per carbon unit that are described as 'priority issues' in the discussion document.[1]

Currently, there are no phase out rates or end dates for any of the protective settings in the ETS.

Continuing delay is not our friend. Neither are abrupt transitions. Yet indefinite delay will make an abrupt transition inevitable. Such an abrupt transition occurred in New Zealand in the late 1980s when most of the government support for agriculture was removed and many farming families suffered.

The economic impacts of a late and abrupt transition to a low-carbon economy have been examined in a report this month from the European Systemic Risk Board.[2] In New Zealand, a Westpac economist has analysed the skewing of the economy that would occur if the agricultural greenhouse gases remain indefinitely outside the ETS.[3,4]

But while it is time to set phase out rates and end dates in the ETS, removing all the protective mechanisms now would be socially as well as economically disruptive. What we need is a way forward that is neither too slow nor too fast – a Goldilocks middle way.

Turning to the first 'priority issue' in the discussion paper, it is my view that the two-for-one surrender obligation should be phased out as soon as possible. This protective mechanism has already been extended three years beyond what was envisaged when it was introduced. As noted on p.12 of the discussion paper, its removal will increase the incentive to reduce emissions and give businesses greater certainty. It will also lead to the earlier surrender of banked units that are essentially 'hot air', helping to restore the integrity of the ETS.

The second 'priority issue' is the $25 ceiling on the price of a carbon unit. It is my view that a price ceiling should remain for now, while New Zealand does not have access to international carbon markets. In the same way as the carbon price fell very rapidly due to the sudden supply of very cheap carbon units, a rapid increase to a high price for carbon would be very destabilising. For the same reason – providing a stable environment for business – a floor should be set on the price of a carbon unit. Over time, both the ceiling price and the floor price would need to be raised.

I recommend:

1. The two-for-one surrender obligation be phased out as soon as possible.
2. A ceiling price for carbon be retained, but be complemented by a price floor, and a commitment made for both to rise over time.

In conclusion

In the lead-up to the Paris conference, the focus was on New Zealand's commitment to reducing greenhouse gas emissions – whether or not our 2030 target was ambitious enough. While the target is important, my concern is how we are going to make the transition to the goal of a low-carbon economy.

I plan to develop some of the thinking in this submission further in the second submission due on the discussion paper in April.

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1. Other protective settings are the intensity basis for calculating the emissions liability of scheme participants and the lack of a phase out rate of the free carbon credits given to carbon-intensive and trade-exposed industries.
2. Report of the Advisory Scientific Committee to the European Systemic Risk Board (ESRB), *"Too late, too sudden: Transition to a low-carbon economy and systemic risk"*, February 2016. The European Commission created the ESRB in response to the global financial crisis.
3. Norman, David, *"The Paris Agreement: What it means for the New Zealand economy"*, Westpac, 4 February 2016.
4. An investigation is currently underway in my office into the fraught issue of the agricultural greenhouse gases – methane and nitrous oxide that make up about half of New Zealand's greenhouse gas emissions.