



Environment Committee
Parliament Buildings
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13 April 2023

Submission on the Climate Change Response (Late Payment Penalties and Industrial Allocation) Amendment Bill

Summary

Of the changes proposed by the Climate Change Response (Late Payment Penalties and Industrial Allocation) Amendment Bill, one issue stands out as being problematic: the proposed change to existing eligibility thresholds for industrial allocation in the New Zealand Emissions Trading Scheme (NZ ETS).

Linking the amount of free allocation to the carbon price would mean that as the carbon price rises (as you would expect if the NZ ETS is doing its job) more free allocation will be given to some NZ ETS participants. It also potentially increases the number of new sectors (and hence emitters) who would be eligible for free allocation. In effect, all those emitters would be allowed to increase their emissions. This seems contrary to the Government's statutory responsibility to reduce emissions.

Clause 15 of the bill (which proposes to amend section 161C(1) of the Climate Change Response Act 2002) should be deleted.

Problems with the proposed change to existing eligibility thresholds

Increased free emissions units undermines the integrity of the NZ ETS

The proposed change is likely to result in a fall in the thresholds for qualifying as either a "moderately emissions-intensive exporter" or a "highly emissions-intensive exporter" if carbon prices rise. As a result, many companies that currently receive assistance would qualify for more.

Based on the current carbon price of \$59,¹ the threshold for moderately emissions-intensive industries would drop from 800 tonnes/\$1 million of revenue to 339 tonnes/\$1 million. The threshold for highly emissions-intensive would drop from 1,600 tonnes/\$1 million to 678 tonnes/\$1 million. In other words, *all* emitters currently classified as moderately intensive would meet the new definition of highly intensive, and therefore could qualify for 87% free allocation compared to their current 57% free allocation. That amounts to an over-50% increase in the amount they currently receive. In effect, they would be allowed to increase their emissions.

Compounding the increase to existing allocation, the lower thresholds potentially permit companies in the sectors that currently cannot receive free allocations to receive them.² The effect would be to inject more carbon credits into the NZ ETS.

¹ Price for 6 April 2023 from Carbon News.

² Provided they meet both the existing criteria and the additional criteria proposed in clause 14.

This is of particular concern because it will further undermine the effectiveness of the NZ ETS as a cap on emissions. This is happening at a time when the credibility of the NZ ETS is already under threat, as evidenced by the recent auction of carbon credits failing to reach the reserve price. Credibility is vital for the NZ ETS to influence the investment decisions that are needed over a long time scale to decarbonise the economy.

To be clear, the rationale for free allocation as it was originally conceived is fair. This is to minimise the risk of “leakage” – carbon emitting exporters moving from Aotearoa New Zealand to other jurisdictions with less stringent carbon reduction regimes. The issue is how much protection by way of free allocation it is reasonable to extend to manage actual risks rather than perceived risks.

A solution in search of a problem

The intention of the threshold change is likewise perfectly fair – to bring the eligibility thresholds up to date with all the changes that have occurred since their creation in 2009. However, the only change the current drafting takes into account is the increase in the carbon price. There are many other factors that influence the risk of leakage which have shifted over the past 14 years:

- As a result of loose NZ ETS settings in the past, a large stockpile of credits has built up (over 101 megatonnes is held by NZ ETS participants in March 2023 according to the Environmental Protection Authority). A large proportion of these will be held by the companies receiving free allocations.
- In 2009 only some countries (mostly in the developed world) were signed up to the 1997 Kyoto Protocol, whereas now almost the entire world has ratified the 2015 Paris Agreement. This means that if emissions intensive exporters move to another country they will negatively impact the nationally determined contribution for that country and can be expected to encounter a less welcoming regulatory environment than might previously have been the case.
- Several of our trading partners now have targets for net zero emissions by 2050 and/or a price on carbon in some form. More countries are adopting such measures over time. As a result, the number of jurisdictions where leakage is likely is shrinking.

All these factors should be taken into account in any change to the thresholds for industrial allocation. While the carbon price has indeed risen, which increases the risk of leakage, these other factors point to a *reduced* risk of leakage.

In the papers supporting the policy decisions on the bill no evidence is presented that the *actual* risk of carbon leakage has increased nor that there is a problem with the current thresholds. It seems the bill is attempting to fix a theoretic risk without actually identifying a real-world problem.

Changing the thresholds for free allocation effectively amounts to a reduction in the relative ambition of the Government compared with 2009. I cannot believe that this is the intention of this change.

Equity issues

This change raises considerable equity issues for who carries the burden of emissions reduction in the New Zealand economy. Under the Climate Change Response (Zero Carbon) Amendment Act 2019, emissions were required to fall at a faster rate than industrial allocations are reducing. By increasing access to free allocations, the gap between protected industries and the rest of the economy would simply be widened. The policy intention behind industrial allocation has always been to phase it out over time, rather than to increase it.

The rest of the New Zealand economy will need to pay for this change in some form; either by reducing net emissions faster or by purchasing offsets from forestry or overseas (assuming that option is even possible). This amounts to a shift in policy with substantial implications for the rest of the economy. The documentation for this amendment bill does not include any economic analysis of the potential scale of this change. For submitters representing non-protected sectors of the economy, transparent analysis of the shift in economic burden-sharing is required to understand the costs that would be imposed by such a radical change.

Recommendation

I recommend the change to the emissions-intensity thresholds be deleted from the bill. If the minister still feels there is a case for changing the thresholds, the proposal should be sent back for far more comprehensive analysis than it has received to date. At a minimum, a more complete economic analysis is needed, followed by public consultation.

Greater analysis should also take place on the real risk of leakage facing our emissions intensive exporters. As part of this, New Zealand's industrial allocation regime could be benchmarked with the European Union Emissions Trading System. If New Zealand aims to be a global leader in emissions reductions, that would be an appropriate starting point for comparisons going forward. If after additional analysis and consultation the change is still desired, it could form part of the NZ ETS review that is currently underway.

I note that He Pou a Rangi Climate Change Commission has made a comprehensive submission on Part 2 of this bill. I support its submission.

A handwritten signature in black ink, consisting of a series of loops and a final vertical stroke.

Simon Upton

Parliamentary Commissioner for the Environment
Te Kaitiaki Taiao a Te Whare Pāremata