

Submission on Te Arotake Mahere Hokohoko Tukunga - Review of the New Zealand Emissions Trading Scheme



Sustainable Business Council

wbcscd Global Network Partner

CLIMATE LEADERS COALITION

ON A MISSION TO REDUCE EMISSIONS IN NEW ZEALAND



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Executive Summary

1. The Sustainable Business Council (SBC) and Climate Leaders Coalition (CLC) are pleased to submit this joint response to the Ministry for the Environment's Discussion Document on the New Zealand Emissions Trading Scheme (NZ ETS) Review.
2. This document represents the collective views of the members of SBC and CLC, a group of more than 160 businesses who contribute more than 40 percent of Aotearoa New Zealand's GDP. SBC is part of BusinessNZ, Aotearoa New Zealand's largest business organisation.
3. We agree with the problem definition set out by the Climate Change Commission and recommend the government urgently clarify the intended balance between gross and net emission volumes.
4. The ETS is an implementation mechanism, it gives effect to policy objectives. We recommend the government use the opportunity presented by the review to seek or set greater clarity about its objectives and the role of this scheme vis a vis other mechanisms.
5. We support a review to consider amending the NZ ETS to provide more robust support for gross emissions reductions. This should underpin the decision-making around options. We would welcome further exploration of a broader set of options, based on the development of a deeper evidence base.
6. We welcome the objective of a strong and steady carbon price signal that is sought through the NZ ETS review. We agree that this review is required and options analysis for reform should be undertaken.
7. Businesses require policy certainty, and we urge that the ETS be kept free of political interference for short-term price controls. The market has demonstrated the impact of this on prices in recent times. We also note the importance of sensitive handling of market-relevant information.
8. The specific recommendations set out in this paper recognise:
 - the importance of balancing the incentives for gross emissions reductions and emissions removals in order to achieve the 2050 net zero target; and
 - the critical role that the NZ ETS will have to play in achieving this balance.
9. Our specific recommendations with respect to reviewing the ETS settings are aimed at:
 - mitigating investor uncertainty due to regulatory changes;
 - ensuring all relevant impacts are recognised and prioritised accordingly;
 - enabling an evidence-based decision-making; and
 - recognising the broader environmental benefits of nature.
10. Our specific recommendations are:
 - i. With regards to **objectives**:
 - Chapter 5 of the consultation document only partially establishes the policy objectives for the ETS. The questions posed in the consultation document reveal several possible outcomes for what a revised ETS could try to achieve. We recommend the government use the opportunity presented by the review to seek or set greater clarity about the objectives of the scheme.

- ii. With regards to **assessment criteria**:
 - We recommend the government provide more clarity on how assessment criteria beyond those that are emissions-focused will be used in deciding between NZ ETS reform options, including how these criteria are weighed against each other. These assessment criteria should be clearly matched to proposed policy objectives.
- iii. With regards to **options identification and analysis**:
 - Urgently clarify the intended balance between gross and net emission volumes. This should underpin the decision-making around options;
 - In assessing available options for reforming the ETS, consider impacts that can emerge during the transition to a new ETS will be understood and treated, these can be long-lasting;
 - Provide clarity with respect to the treatment and validity of NZUs currently backed by forestry removals in the new ETS regime. We recommend that the property rights linked to current NZUs be grand-parented; and
 - Provide a more detailed analysis of expected price impacts from each of the ETS reform option.
 - Consider a broader list of options, or options in combination.
- iv. With regards to **broader environmental outcomes and removal activities**:
 - Prioritise the development of a national sequestration strategy that recognises the environmental, social, and economic benefits of a well-balanced use of sequestration as a mitigation tool; and strengthens incentives for emissions removal activities with broader environmental outcomes and co-benefits beyond sequestration (e.g. indigenous forest biodiversity). The strategy should then be used to inform the choice of the policy implementation mechanism.

1. Introduction

SBC/CLC support the domestic emissions reduction targets and purpose of the Climate Change Response Act 2002 (the Act) to contribute to the global efforts under the Paris Agreement to limit warming to 1.5 degrees above pre-industrial levels.

We recognise that the NZ ETS plays a significant role in achieving New Zealand's emissions reduction commitments, and we welcome the opportunity to comment on the Review of the New Zealand Emissions Trading Scheme, *Te Arotake Mahere Hokohoko Tukunga*.

This response draws on our previous publications:

- *Pre-election Briefing Paper: Policy priorities for accelerating climate action and building a resilient Aotearoa* (2023 report, available [here](#))
- *Submission to the Climate Change Commission on Draft Advice on the second emissions reduction plan (2026-2030)* (2023 CCC submission, available [here](#))
- *Submission to the Climate Change Commission on 2021 Draft Advice for Consultation* (2021 CCC submission, available [here](#)).

In preparing our submission, we have been guided by the principle that New Zealand's 2050 target requires a strong and stable carbon price to drive investment and behaviour change that will reduce gross emissions. On this basis, our view is that the NZ ETS should continue to be reformed to best fulfil its central role in pushing choices towards low-emissions alternatives.

Although we welcome the objective of a strong carbon price signal that is sought through the NZ ETS review, we also note that the pace of the transition and our ability to collectively ensure it is an equitable one, are important factors in business investment decision-making.

A rising carbon price is important for incentivising gross emissions, but it also risks impacting hardest on lower income households, or SMEs, if they're unable to access the same low emissions, lower cost opportunities as others. Barriers to the equitable transition require ongoing collaboration between government, business, and wider society. A higher carbon price will also significantly affect sectors that do not currently have alternative technology options available to them to decarbonise.

In our previous publications, we noted that complementary policy measures will be important for mitigating some of these equity impacts (see our submission on the draft advice to the first emission reduction plan, and Appendix 1 for recommendations in our [Pre-Election Briefing Paper](#)). We reiterate this point here. We note that a better understanding of the carbon price pathways through the NZ ETS review will be important not only for driving incentives to reduce carbon emissions over the long-term, but to also get a better grasp of the kinds of complementary policies that will be required.

This is important to ensure that the distributional impacts of the transition can be mitigated whilst maintaining the integrity of the ETS. Businesses require policy certainty, which means the ETS should be kept free of political interference for short-term price controls. Instead, complementary policies should be used to address unintended consequences during the transition.

In summary, as well as actions to improve the effectiveness of the NZ ETS, we urge the government to maintain focus on complementary policies as part of a fuller suite of policy instruments needed to deliver on our 2050 target.

2. Objectives and assessment criteria

Key recommendations:

- Chapter 5 of the consultation document only partially establishes the policy objectives for the ETS. The questions posed in the consultation document reveal several possible outcomes for what a revised ETS could try to achieve. We recommend the government use the opportunity presented by the review to seek or set greater clarity about the objectives of the scheme.
- Provide more clarity on how assessment criteria other than those emissions-focused will be used in deciding between NZ ETS reform options, including how these criteria are weighed against each other.

Gross vs net

In its draft advice to the second Emissions Reduction Plan, the Climate Change Commission has suggested that the NZ ETS be reformed to decouple incentives for gross emissions reductions and afforestation. SBC/CLC are concerned by the Commission's statement that the current settings risk a 'boom-and-bust' cycle for forestry, given the implications for climate policy and action over the next 10 years.

Therefore, SBC/CLC welcome the Review's objective to assess the role that the NZ ETS can play in prioritising gross emissions while maintaining support for removals. In our response to the Climate Change Commission's draft advice on the second ERP, we supported an explicit focus by the government on gross emissions reductions, which aligns with the commitments made by our members.

The NZ ETS is one of the key instruments to achieve net zero by 2050, and we support a functioning NZ ETS aligned to the outcomes Aotearoa New Zealand has set. Settings should include ambition for gross emissions reductions, and the NZ ETS should reflect that.

However, we urge that the ambitions for gross emissions should be made more explicit, in line with the Climate Change Commission's recommendation in its draft advice for the second emissions reduction plan. We discuss this in the next section.

Primary objective for the NZ ETS review

Although we agree with the primary objective of the review itself, it is not clear what the intended outcomes from a revised ETS are. For example, under option 4 in Chapter 6, the ETS could be reformed so it is entirely focussed on delivering gross emissions reductions, with the incentives for removals being managed within a separate mechanism.

We recommend the government use the opportunity presented by the review to seek or set greater clarity about the objectives of the scheme.

Assessment criteria

In the discussion document, two primary assessment criteria are used to assess the options for NZ ETS review: whether the option (i) incentivises additional gross emissions reductions, and whether it (ii) incentivises emissions removals. These criteria reflect the ETS' primary function of controlling carbon emissions, are consistent with the review's objective, and we agree with them in principle.

However, through its pricing mechanism, the NZ ETS impacts New Zealanders in many other important ways. Although we support the end target of a functioning ETS with a strong and stable price signal that drives gross emissions, and that drives removals over time in a way that meets our 2050 and international requirements, we note that the process of getting there is also very important.

The two criteria focus on future steady states of an NZ ETS, with no consideration given to impacts during the transition to a reformed NZ ETS, which can be long-lasting. These include impacts on current investments and investors, appetite for future investments, equity, and distributional outcomes in particular.

We note that the discussion document provides a qualitative assessment of options against additional criteria such as NDC contribution, NZ ETS market functionality (which in turn includes considerations of complexity and fairness), costs, Te Tiriti and Māori interests, and co-benefits. However, this extended list is not included in the summary comparison of options. We would like more clarity on how these additional criteria, which are also important, are applied (including how they are weighed against each other) when deciding between NZ ETS reform options.

With respect to the specific criteria of NZ ETS functionality, we would also like to see an assessment of how policy uncertainty would be mitigated during the transition to a new NZ ETS regime, as this has a significant impact on the investment climate. This should be included in the description of options themselves, as we discuss in the next section.

3. Options identification and analysis

Key recommendations:

- Urgently clarify the intended balance between gross and net emission volumes. This should underpin the decision-making around options.
- In assessing available options for reforming the NZ ETS, consider impacts that can emerge during the transition to a new ETS, which can be long-lasting.
- Provide clarity with respect to the treatment and validity of NZUs currently backed by forestry removals in the new ETS regime.
- Provide a more detailed analysis of expected price impacts from each of the NZ ETS reform option.

The balance between gross and net incentives

We support the recommendation that the reformed ETS prioritises gross emissions reductions while maintaining incentives for removals, as this will be important to Aotearoa New Zealand meeting its long-term commitments, both domestic and international.

However, we note that the current uncertainty around the balance between gross and net emission volumes significantly undermines the integrity of the ETS. We urge the government to provide more clarity around its intentions with respect to the specific gross and net emissions volumes in the upcoming emissions budgets, as recommended by the Climate Change Commission.

In particular, in its draft advice for the second Emissions Reduction Plan, the Climate Change Commission recommended that the government provides clarity on the intended contribution from gross emissions, including by committing to specific levels of gross emissions in the second and third emissions budgets. This is relevant for the NZ ETS review because it would provide more certainty on volumes, and particularly around the expected maximum gross cap and maximum removals of forestry. It would also help inform important decisions around design implementation.

We would like to see a standalone analysis of how the government intends to make decisions around the gross-net balance, and how these decisions will impact detailed choices on NZ ETS reform implementation. This analysis should underpin the decision-making around ETS reform options.

Evidence-based decision making

The discussion document provides a qualitative assessment of some of the impacts expected from the options proposed. Further detailed modelling and analysis will be undertaken before the government makes its final decision on the NZ ETS review. We understand that the discussion document is meant to provide transparency about the government's line of thought on the one hand, and to gather evidence on the other.

We welcome and support the government actively engaging with stakeholders for the purpose of policy design. As a matter of principle, we support evidence-based decision-making. As well as evidence on investment response to NZU prices (as explicitly requested in the document), the evidence should include a broader consideration of potential economic, social, and environmental impacts during the *transition* to a new ETS regime.

However, we also note that the evidence-gathering process can take time, which in turn can prolong the period of uncertainty around the future of ETS, undermining the overall credibility of the market. To

mitigate this, and as discussed above, it is crucial that the government clarifies the balance between gross and net emissions volumes, and that it does so with urgency.

Specific options analysis

The review proposes four high-level options, with a possibility of a fifth, hybrid option, that would combine elements from the other four:

1. Use existing NZ ETS levers to strengthen incentives for net emissions reductions
2. Create increased demand for removal activities to increase net emissions reductions
3. Strengthen incentives for gross emissions reductions by changing the incentives for removals
4. Create separate incentives for gross emissions reductions and emissions removals.

Based on the limited information available through this initial consultation SBC/CLC support the further development of option 4, potentially being most effective at prioritising incentives for gross emissions reductions, and maintaining support for removals.

However, we note that over the course of this consultation MfE have said that further information including detailed price modelling of the options proposed would be released in a subsequent consultation exercise. We believe this information, as well as other information around impact analysis for example, is key to progressing options analysis and could have a material impact on the option/s SBC and CLC members support.

We remain interested as to other options not listed above.

We are concerned with the uncertainty around the value of NZUs currently backed by forestry. Our members are committed to New Zealand's net zero target, and policy certainty is critical to unlocking and deploying the investments required to that end.

We therefore urge the government to provide more clarity with respect to the treatment and validity of NZUs currently backed by forestry removals in the new ETS regime. Our position is that NZUs already issued should be grandparented on the basis of ease of implementation, but more importantly on equity and property rights concerns. We also urge the government to provide more detailed analysis of expected price impacts from each of the option.

4. Broader environmental outcomes and removal activities

Key recommendations

- Prioritise the development of a national sequestration strategy that recognises the environmental, social, and economic benefits of a well-balanced use of sequestration as a mitigation tool, and strengthens incentives for emissions removal activities with broader environmental outcomes and co-benefits beyond sequestration (e.g. indigenous forest biodiversity).
- The national sequestration strategy should then be used to inform the choice of the policy implementation mechanism.

Nature has a critical role in realising the triple dividend of sequestration, climate adaptation and biodiversity gains. Nature provides critical solutions for both mitigation and adaptation, and it must be protected or enhanced through our climate action.

Nature-based solutions are a key action in the Emissions Reduction Plan, and should underpin any changes to the ETS. These solutions are often cheaper and more effective over the long-term than hard infrastructure, like seawalls. Nature-based solutions (NBS) include large-scale coastal and freshwater wetland restoration, riparian planting, the re-wetting of peatlands, and the establishment of permanent indigenous forests in erosion-prone areas.

We are concerned about the scale of exotic afforestation witnessed over the past years, and the misalignment between the incentives for exotics and achieving gross emissions reductions. In its draft advice to the second Emission Reduction Plan, the Climate Change Commission notes that the level of carbon dioxide removals by forests could exceed demand from NZ ETS sectors beyond 2030s; consequently, the weakened carbon price signal would jeopardise the NZ ETS' role in driving investment in gross emissions reductions and further afforestation.

In addition, we also note extensive planting of exotics carries risk to meeting our climate, adaptation, and biodiversity objectives. Exotic forests will become increasingly exposed to risk, from pests, disease, and extreme weather amongst other threats.

We therefore agree that incentives should be strengthened for emissions removal activities with broader environmental outcomes and co-benefits beyond sequestration (e.g. indigenous forest biodiversity).

However, we note that for sequestration outside of forests, careful consideration needs to be given to the role these could play in meeting our targets, domestic and international. Considerations could include scientific basis, permanence, risk, and cost.

We stress our previous recommendation for the urgent need to develop a National Sequestration Strategy that identifies opportunities for nature-based sequestration, assesses alternative uses of resources, and balances choices against the need to value and protect our natural capital. This strategy should then underpin the choice of the policy instrument to reward these activities.

We understand that the development of a Carbon Removals Strategy is progressing alongside the NZ ETS review. Although we welcome the work underway on the Strategy, we would like more clarity on the feedback loops between the Carbon Removals Strategy and the choice of the pricing instrument (NZ ETS or other) for broader environmental outcomes. We recommend that priority is given on the development

of the Carbon Removals Strategy, which should then inform the choice of the policy implementation mechanism.

With respect to the Carbon Removals Strategy specifically, we reiterate our recommendations from the Pre-election Briefing Paper that the Strategy should:

- Provide a representation of current land use and sequestration opportunities.
- Consider desired outcomes at a national level, taking account of nature-based solutions (NBS) to emissions reduction and land-use.): NBS support a farm system approach and have the potential to deliver a triple dividend: both gross and net emissions reductions, biodiversity gains and climate adaptation benefits. NBS can also result in nature-positive products by creating a virtuous circle of co-benefits that amplify any investment (see Appendix 2). The strategy should therefore prioritise sustainable land use ('right activity, right place'), resilient and thriving rural communities, maintaining, and growing food and fibre exports, and be linked with the essential freshwater and indigenous biodiversity policy initiatives.
- Consider wider natural ecosystem benefits, with an aim to protect our natural capital.
- Address the ongoing need to offset carbon emissions and creates a balance across the environmental, social, and economic benefits of exotics and natives.
- Introduce financial reward / offsets for permanent native forestry.
- Recognise on-farm sequestration opportunities, and the offsets from reforestation projects and community restoration projects, e.g. wetland restoration
- Set the context for developing the necessary rules and standards to affirm the quality of new sequestration activities, while considering international developments with respect to the fungibility and quality of offsets. A process for monitoring and enforcing standards should also be considered.
- Recognise our domestic and international commitments to protect and enhance biodiversity. In 2020, New Zealand launched its Biodiversity Strategy in 2020, setting out the strategic framework for the protection, restoration and sustainable use of biodiversity from 2020 to 2050¹ In 2022, New Zealand joined a global deal to halt biodiversity loss and adopt the '30x30' initiative to protect 30% of land and of ocean by 2030.² Against this backdrop, we welcome the government's launch of a separate consultation on the package of measures to protect native biodiversity³
- Consider regulation that allows for inclusion of robustly proven sequestration pathways outside forestry and agriculture, to incentivise research and implementation of these options. We note, for example, accelerated, permanent recarbonisation of cement is emerging as a credible sequestration pathway.

¹ <https://www.doc.govt.nz/nature/biodiversity/aotearoa-new-zealand-biodiversity-strategy/>

² <https://www.beehive.govt.nz/release/new-zealand-welcomes-new-global-deal-nature>

³ <https://www.beehive.govt.nz/release/government-launches-comprehensive-package-measures-protect-native-biodiversity#:~:text=Biodiversity%20credits,both%20wildlife%20and%20local%20communities>

Appendix 1: SBC/CLC Pre-election briefing paper

Our *Pre-election briefing paper: Policy priorities for accelerating climate action and building a resilient Aotearoa* represents the latest thinking from SBC/CLC members on options to accelerate emissions reductions and address adaptation needs.

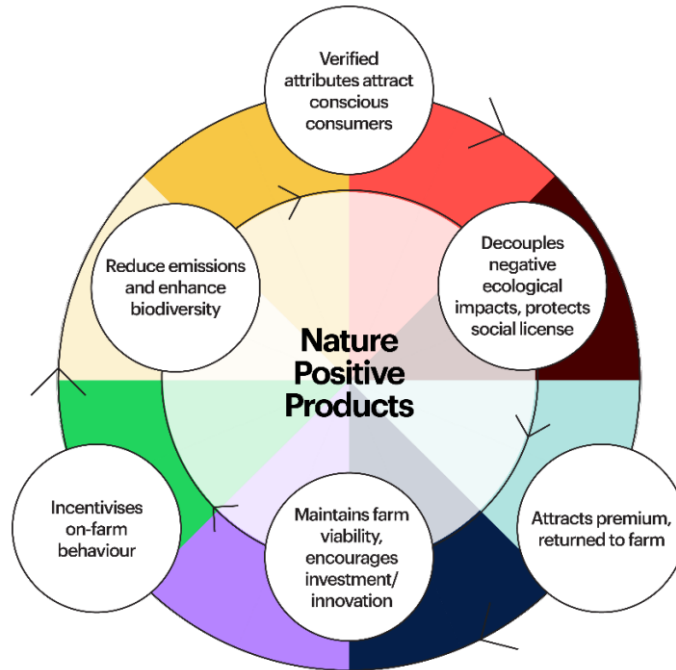
In summary, CLC/SBC recommend actions that will enable business to go further, faster to reduce their emissions while working with the government to provide clear direction and partnership on climate adaptation. These include:

We recommend an incoming government:		
1. Maintain and uphold the climate change response architecture	1.1	Commit to maintain and uphold the climate change response architecture.
2. Accelerate action on climate adaptation while maintaining momentum in reducing emissions	2.1	Accelerate action on both emission mitigation <i>and</i> proactive climate adaptation, by also considering nature-based solutions to adaptation
	2.2	Work with business and local government to provide greater clarity on short and long-term direction on adaptation
	2.3	Urgently review the size and scope of funding plus roles and responsibilities required to support climate change adaptation
	2.4	Implement the Infrastructure Commission’s recommendations on strengthening resilience to shocks and stresses
	2.5	Partner with business to take immediate action in areas already impacted by climate change
3. Accelerate transport decarbonisation in light and freight fleets	3.1	Implement actions to accelerate decarbonisation of the light passenger travel through electrification and mode shift, with a particular focus on charging infrastructure capacity and alignment with EU standards
	3.2	Implement actions to decarbonise heavy freight through optimisation of decarbonisation options, fuel switching and mode shift
	3.3	Prioritise investment in low and zero emissions rail and coastal shipping, two key sectors for enabling freight mode shift
	3.4	Develop and implement a strategy to decarbonise aviation

4. Increase investment in infrastructure for decarbonisation and electrification	4.1	Prioritise completion of the New Zealand Energy Strategy and take a whole-of-system approach to complementary energy policies
	4.2	Amend regulatory settings to enable regulated infrastructure to support the decarbonisation of the economy
	4.3	Provide clear consenting pathways for energy infrastructure as part of the RMA reform
	4.4	Implement policy measures to incentivise the uptake of distributed renewable technologies
	4.5	Recognise the need for renewable energy certification
5. Maintain focus on reducing agriculture emissions	5.1	Reduce agricultural emissions through the Centre for Climate Action joint venture
	5.2	Identify tools to help farmers transition to a low emissions economy and adapt to the changing climate
	5.3	Promote a nature-based solutions (NBS) approach to assessing the environmental impacts from agricultural practices
6. Accelerate action to ensure a just transition	6.1	Complete the Equitable Transitions Strategy in 2023 and work with business and other stakeholders to ensure the Strategy is implemented
7. Decarbonise industrial processes (especially process heat)	7.1	Decarbonise industrial processes (especially process heat) through the public-private action resulting from the GIDI fund
8. Reduce emissions from waste and the built environment	8.1	Implement actions to support circular economy initiatives
	8.2	Improve waste recovery, recycling rates, and waste tracing
	8.3	Provide policy direction on organic waste as part of the Bioeconomy Strategy
	8.4	Reduce emissions and waste from the built environment through necessary amendments to the building code, requiring embedded carbon measurements and undertaking a large-scale retrofit programme
9. Implement a national sequestration strategy that protects nature	9.1	Develop a national sequestration strategy that recognises the environmental, social, and economic benefits of a well-balanced use of sequestration as a mitigation tool

10. Improve the disclosures framework	10.1	Ensure climate scenario assumptions are used consistently for the purpose of climate disclosures
	10.2	Improve guidance on the disclosure of Scope 3 emissions
	10.3	Explore in partnership with business the introduction of Nature-related Financial Disclosures in the New Zealand market

Appendix 2: Nature-positive products



Source: Silver Fern Farms

About Sustainable Business Council

The Sustainable Business Council (SBC) is a CEO-led membership organisation with more than 130 businesses from all sectors, ambitious for a sustainable New Zealand. Members represent more than \$118 billion–of collective turnover, 33 per cent of GDP, and nearly 190,000 full-time jobs. Our network gives members the ability to take large-scale collective action. SBC is part of the BusinessNZ network and is the New Zealand Global Network partner to the World Business Council for Sustainable Development. www.sbc.org.nz/about/our-members/sbc-members

About Climate Leaders Coalition

Formed in 2018, the Climate Leaders Coalition has a mission of having New Zealand business CEOs leading the response to climate change through collective, transparent and meaningful action on mitigation, adaptation and transition. Together their signatories represent 34% of GDP, employ more than 210,000 people and have a collective turnover of \$126 billion. <https://www.climateleaderscoalition.org.nz>

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