



# IETA Response to the New Zealand ETS Review Consultation

6 April 2016

## **About IETA**

[IETA](#) is a non-profit international business organisation that promotes the establishment of a functional global framework for trading in greenhouse gas emission reductions. We seek to develop an emissions trading regime that results in real and verifiable greenhouse gas emission reductions, while balancing economic efficiency with environmental integrity. To achieve these goals, an emissions market requires scarcity, and long-term clarity and predictability of the rules, including the emission reduction target.

Established in 1999, IETA is the leading voice of the business community on the subject of carbon markets. IETA's members comprise more than 130 companies from across the carbon trading spectrum, and who are active in jurisdictions where carbon pricing policies are in place, being implemented or considered. IETA's members include global leaders in the oil, electricity, cement, aluminium, chemical, paper, technology, data verification, broking, trading, legal, finance, and consulting industries.

IETA warmly welcomes the publication of the discussion document and the call for written submission in the context of the New Zealand Emissions Trading Scheme Review. IETA's submission covers the second section of the call for written submissions, "**Other issues**", with particular attention to the following topics:

- Business responses to the NZ ETS
- Protecting competitiveness through free allocation
- Managing unit supply, including issues related to forestry, international units and selling New Zealand Units (NZUs) by auction
- Managing price stability.



## Other issues: business responses to the NZ ETS

### 10. What would improve your ability to take into account the future cost of emissions in your business planning?

IETA members overwhelmingly support emissions trading as a tool to put a price on carbon and combat climate change because of its ability to deliver cost-efficient emissions reductions, by creating economic scarcity of emission allowances over time in a predictable manner. Confidence, transparency and predictability are essential for the efficient functioning of the carbon market and to deliver a clear, long-term price signal that allows business to design effective and ambitious plans to decarbonise.

Therefore, it is important to provide rules that are long-term, predictable and adequate in order to minimise the regulatory risk faced by operators and forestry participants. They would also ensure predictability for market participants on the emission reduction pathway and the level of scarcity foreseen in the market in the long-run.

We note that the review is at large focused on demand-side reform. However, significant supply-side reform (for example, the introduction of international units or increased auctioning) is to be expected as we move close to 2020. We therefore urge the government to signal its planned intentions and timeline as soon as possible.

Moreover, the Paris Agreement includes a mechanism to perform a global stocktake of GHG emissions, with a view to reviewing the level of ambition globally every five years. It therefore becomes important to spell out what the process would be for such periodic reviews in the context of the NZ ETS, in order to have clarity on how and when changes in the ETS would occur.

## Other issues: protecting competitiveness through free allocation

### 11. Under what conditions should free allocation rates start to be reduced after 2020?

IETA believes that free allocation is an effective tool to create a level-playing field to protect sectors against the risk of carbon leakage and to safeguard competitiveness, both domestically and internationally. Free allocation should remain in place after 2020 for those sectors exposed to the risk of carbon leakage, while it should be phased-out for others.

Carbon leakage occurs when direct and indirect carbon costs deriving from an asymmetrical climate policy have a material impact on competitiveness, leading to industrial production and/or new investments moving outside a regulated region, which would lead to higher associated emissions.

An appropriate level of support through free allocation is needed for sectors at risk of losing international competitiveness as a result of the implementation of front-running climate policies, and with a view of rewarding the most efficient installations. On the other hand, sectors not at risk of carbon leakage should not receive free allowances, and auctioning should be used as the default allocation method.

Carbon leakage provisions should be in place for targeted sectors or subsectors that show clear evidence of being exposed to a risk of carbon leakage. This risk would be a result of carbon-



related costs, combined with an inability to pass on these costs and a significant level of trade exposure. These costs would arise from the decision to implement policies that result in a higher price on GHG emissions than in other jurisdictions.

It is worth noting that the primary cause of carbon leakage is the asymmetrical uptake of climate policies in different jurisdictions and therefore the risk can be alleviated by the uptake of climate policies by New Zealand's main trading partners. Thus, carbon leakage provisions need to reflect developments in climate policy in other jurisdictions, and should be transitional in nature, as more and more countries around the world start to adopt domestic climate policies – therefore reducing the risk of carbon leakage.

Access to international units is an additional measure to ensure that New Zealand, an export-driven economy, maintains a level playing field with its major trading partners as prices are normalised. Further considerations on international units are outlined in the response to question 16.

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**12. What impact would it have on your investment decisions over the next few years if there was a clear pathway or criteria for phasing out of free allocation after 2020?**

As outlined in our response to question 10, IETA believes that regulatory interventions, such as the phasing out of free allocation, should be put forward in a long-term, predictable and adequate manner in order to minimise the regulatory risk faced by operators. This allows business to take correct investment decisions. IETA believes that free allocation should continue as long as there are asymmetrical climate policies.

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**Other issues: managing unit supply - forestry**

**14. Are there opportunities for the NZ ETS to increase incentives for forestry investments, outside of NZU price?**

**Yes**

**15. What are your reasons for the above answer? If you answered yes, we would be interested in comments on:**

**b) other factors**

By creating long-term policy certainty so that, regardless of the NZU price, entities have confidence to enter long-term contracts.

Lack of information on entities' liability is a barrier to entrance. More information, data availability and transparency, for instance on the disclosure of emissions at the entity level, would reduce barriers to participating in the NZ ETS.



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## Other issues: managing unit supply – international units

**16. If international units are eligible for NZ ETS compliance in the 2020s, should any of the following restrictions be placed on their use?**

**c) others**

**Please explain your answer.**

IETA believes that allowing the use of international credits is in New Zealand’s long-term interest, because it can broaden the impact of the ETS by offering market access for high-quality trading systems and carbon offsets. It is a classic “win-win” strategy, since it encourages global participation and offers a cost-effective compliance option for regulated companies.

International units eligible for compliance under the NZ ETS should include internationally-recognised emissions reduction credits generated by project-based mechanisms as well as international allowances. Moreover, the NZ ETS framework should also contain provisions for the inclusion, in the post-2020 period, of international units developed under the Paris Agreement. Articles 5 and 6 of the Paris Agreement pave the way for the expansion of a REDD+ framework and for the development of a new mechanism, the so-called ‘sustainable development mechanism’. Therefore, units generated through these mechanisms should be eligible for compliance under the NZ ETS.

The use of international credits should:

- Ensure the highest possible environmental integrity and additionality; and
- Encourage other jurisdictions to fight climate change by providing market access to the NZ ETS as an incentive.

In considering how to structure this element of the ETS policy, IETA recognises that it must operate within well-defined parameters. Allowing an uncontrolled flow of credits is not a sustainable solution for an ETS, because it may not drive sufficient investment in abatement strategies within the covered sectors. We have seen from the experience in other ETSs that focusing primarily on quantitative restrictions can lead to distribution problems about which operators gain access to credits, and about the extent to which different developing countries benefit. We would recommend clear and strict criteria that would define the quality of international credits and place percentage limits on the total number that could be used in the NZ ETS.

The role of credits within the NZ ETS should satisfy the following principles:

- **Integrity:** International credits, which will be recognised under the Paris Agreement, should represent real, permanent and additional reductions, and be subject to robust monitoring, reporting and verification (MRV). It is therefore essential to ensure common and consistent MRV processes. One tonne of reductions located outside New Zealand should equal at least one tonne of reductions within New Zealand. Clear quality criteria



need to be agreed at the UN level from the outset, to allow individual and sectoral projects to develop once they meet minimum criteria set by the UNFCCC.

- **Scarcity:** The use of international credits should not call into question the principle of having scarcity in the NZ ETS and ensuring a meaningful price signal for low-carbon investment.
- **Regulatory stability:** The extent to which international credits should be allowed (volume and type) should be defined as early as possible. This offers market participants visibility on what to expect in terms of market dynamics, and it helps to avoid a sudden inflow or outflow of credits when rules get modified.
- **Compliance with UNFCCC Framework:** International credits should comply with the evolving framework established by Article 6 of the Paris Agreement.

Criteria on the type of international credits could include the following:

- **Country type:** The partner country should be making proactive efforts to reduce its emissions/emissions intensity.
- **Clear additionality:** Offset projects should meet a clear additionality standard set by determining an appropriate sectoral benchmark for the country or region. Projects with clean technologies that abate significant levels of GHG emissions should flourish as a result.
- **Credibility:** UN-issued credits could be recognised, to ensure that qualitative criteria are guaranteed.
- **Net mitigation contribution:** The extent to which a project counts against a host country's efforts to reducing their domestic emissions should be clearly established, to assure that there is no double counting. Net mitigation could be set by project type and/or by country type.

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## Other issues: managing unit supply – auctioning

### 17. Should auctioning be introduced in the NZ ETS?

**Yes**

If yes, when?

**c) after five years (post 2020).**

### 18. What should be the role or purpose of an auctioning function in the NZ ETS, if one were introduced?

**c) other**

**Please explain your answer.**



If auctioning were to be introduced in the NZ ETS, considering the uncertainty around the exact supply level required and as a way to introduce market stability, a mechanism should be introduced to ensure that the market is able to adapt to demand changes, so that an adequate price signal is generated. IETA supports auctioning as an efficient and fair way of allocating allowances. The purpose of an allocation method is to distribute carbon scarcity to the economy as equitably, predictably and efficiently as possible. The allocation process itself should not pre-determine market outcomes. The use of auctioning as an allocation method for emissions trading should be carefully considered on the basis of both equity and efficiency. Auctioning has significant appeal as an allocation method for an emissions trading system, and may address some of the shortcomings that have been observed in emissions trading in other jurisdictions.

Arguments in favour of auctioning include:

- Simplicity – if designed right;
- Equal access to allowances;
- Engages emitters in the ETS transparency;
- Aligns with the ‘polluter pays’ principle;
- Addresses concerns over windfall profits;
- Removes politics from allocation.

Moreover, an ideal auctioning method should follow these principles:

- Be open, transparent and simple;
- The bulk of the proceeds must be recycled to further the environmental objective;
- Provide long-term regulatory predictability;
- Be periodic, timetabled and coordinated;
- Cause no large distributive effects;
- Be implemented gradually;
- Take into account the need for new investment;
- Auctioning revenues should be reinvested for climate related purposes and to help ETS sectors.

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## Other issues: managing price stability

### 21. Do you think measures should be in place to manage price stability?

**Unsure**

**Please explain your answer**



IETA would caution against the introduction of measures aimed at directly influencing market prices, as market prices should be a function of the long-term environmental objective and of the market balance, and should not be imposed via regulations. On the other hand, IETA believes that the introduction of measures aimed at increasing transparency and long-term regulatory predictability, such as a market stability mechanism, would aid in improving price stability and in establishing a long-term price signal. IETA believes that introducing a market stability mechanism will likely improve the functioning of the NZ ETS and would ensure its effectiveness in providing a long-term price signal for the necessary emission reductions.

IETA believes that the objective of a market stability mechanism is to make the system resilient to future large, unanticipated, and exogenous changes in demand for allowances. Such shocks could result from, eg, economic growth or slowdown, technological breakthroughs, policy overlap, etc. A stability mechanism should also be designed to mitigate the impacts of future excessive oversupply in the market and improve the functioning of the NZ ETS, which will depend on the criteria chosen for such a mechanism.

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## 22. What do you consider are important factors for managing price stability?

### c) other

#### Please explain your answer

While reiterating the previous point on the need to avoid direct price interventions, IETA would like to outline the following principles for an effective market stability mechanism. The expected effectiveness of such a mechanism is closely linked to the type of triggers chosen, according to which the supply of allowances would fluctuate. In the context of the EU ETS, IETA recommended the adoption of an emissions-based trigger as the preferred option.

In this approach, a lower and upper threshold would be defined. Whenever either threshold is reached, an automatic adjustment in the volume of auctioned allowances would take place.

IETA has identified key principles for putting in place such a mechanism:

- It needs to be transparent and based on clearly pre-defined rules;
- It needs to lead to automatic changes, rather than depend on political decisions ;
- It should work within the existing architecture and use data which is already publicly available;
- It should be simple and readily understood;
- It needs to be neutral to the overall cap of allowances, and should be rooted in the long-term context of setting targets;
- It needs to be carefully monitored and assessed;
- It should not increase the risk of carbon leakage.



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### **23. What should the Government consider when managing price stability?**

IETA recognises the challenge of designing a market stability mechanism that can meet all these principles. Clarity is needed on the possible consequences of introducing flexibility in the system with regards to:

- The functioning of the system;
- The frequency of the interventions;
- The regulatory risk that such a mechanism provides both a regulatory precedent and a mechanism for more and stronger interventions;
- Finding a balance between changes in the supply taking place on a regular basis or only in exceptional circumstances;
- Adding complexity to the ETS.

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