

# CARBON MARKET BUSINESS BRIEF

## NEW ZEALAND

### NZ ETS AT A GLANCE

Years in operation	Began in 2008. Annual compliance periods, with units due to be surrendered by 31 May of the subsequent year.
Overall cap & trajectory	In 2020, the government set an economy-wide provisional emissions budget of 354 million tCO <sub>2e</sub> for 2021-25 and an ETS overall limit of 167 million tCO <sub>2e</sub> (90 Mt CO <sub>2e</sub> for auctioning, 43 million tCO <sub>2e</sub> for anticipated free allocation, and 35 million tCO <sub>2e</sub> in the cost containment reserve). Under draft advice from the independent Climate Change Commission (February 2021), the emissions budget would reduce to 341 Mt CO <sub>2e</sub> over 2021-25, 286 million tCO <sub>2e</sub> for 2026-30 and 223 million tCO <sub>2e</sub> for 2031-35, with consequential changes to ETS unit settings (not detailed). The Commission will give its final advice in May, and the government will decide by the end of 2021.
Target(s)	Under the Paris Agreement, New Zealand committed to a 30% cut in net emissions below gross 2005 levels by 2030. The government has signalled it intends to adjust the NDC in 2021 following advice from the Commission. The country has legislated for a 2050 target of at least a 24-47% cut in biogenic methane below 2017 levels (including a 10% cut by 2030) and net-zero emissions of other GHGs.
Emissions Reduced to date	Pre-pandemic, the NZ ETS was projected to reduce net 2020 emissions by 2.9 million tCO <sub>2e</sub> (annually).
Sectors covered	<ul style="list-style-type: none"> <li>• Forestry (mandatory for deforestation of pre-1990 forest land; voluntary for post-1989 afforestation)</li> <li>• Liquid fossil fuels</li> <li>• Stationary energy</li> <li>• Industrial processes</li> <li>• Waste</li> <li>• Agriculture (reporting only)</li> </ul> <p>Under legislation passed in June 2020, agriculture will face an emission price no later than 2025, and a voluntary permanent forestry activity for post-1989 forests will be introduced in 2023.</p>
GHGs covered	CO <sub>2</sub> , CH <sub>4</sub> , HFCs, N <sub>2</sub> O, PFCs and SF <sub>6</sub>
# of covered entities	As of December 2020, there were 272 mandatory participants (of which 77 are agricultural processor entities with reporting obligations only) and 2444 voluntary participants (of which 2138 conduct post-1989 forestry).
Allocation method	<p>Output-based free allocation to emissions-intensive, trade-exposed (EITE) industry. Historically, one-off free allocations to fishing quota owners and pre-1990 forest owners. Post-1989 forest owners (or lease/rights holders) can opt to earn units for net removals.</p> <p>Quarterly auctions were introduced in 2021, hosted by NZX and EEX. A total of 19 million NZUs are being auctioned in 2021, while the 2022 volume will be determined pending government decisions on New Zealand's emissions budgets after final recommendations from the Commission.</p>

Trading rules	Unlimited banking and no borrowing
Use of offsets and linking	Overseas Kyoto Protocol units were eligible until mid-2015. At present, no overseas units are eligible and any future use of approved overseas units by participants will be bound by the cap. The NZ ETS is not linked to systems in other jurisdictions. Two domestic unit mechanisms (Permanent Forest Sink Initiative and Negotiated Greenhouse Agreements) will end before 2023.
Other features	<p>For emissions through 2019, emitters could opt to pay a fixed price of NZ\$25/t for compliance, which rose to NZ\$35/t for 2020 emissions in 2021. The 2020 reform legislation established a cost containment reserve (CCR) and an auction reserve price (ARP). The CCR will release a fixed volume of NZUs into auctions if the unit price reaches a trigger price starting at NZ\$50/t in 2021. The ARP started at NZ\$20/t in 2021. These thresholds will rise by 2% annually to correct for inflation. In its draft advice, the Commission recommended raising the CCR trigger price to NZ\$70/t and ARP to \$30/t as soon as practical, with annual increases of 10% and 5% plus inflation (respectively). In March 2021, the government introduced a Confidential Reserve Price to operate in addition to the ARP. This is set by the Minister based on prevailing prices in the secondary market.</p> <p>In the energy sector, surrender obligations generally apply upstream at the point of fuel production or import, but large fuel users can opt in to surrender obligations with a carve-out of the upstream obligation.</p>
Penalties for non-compliance	Following the reforms in 2020, the penalty for failure to surrender units has increased to three times the market price plus the surrender requirement and adjusted penalties will apply for other types of infringements.
Use of revenues	At present, auction revenue will be returned to the Crown account. The government is considering options for how to use the revenues and will be reporting to Cabinet in 2021.

## MAJOR DEVELOPMENTS

Legislation to reform the NZ ETS was introduced to Parliament in October 2019 and passed in June 2020. The legislation enacted reforms arising from the 2015/16 review of the NZ ETS and subsequent public consultation. Key changes include the introduction of auctioning within a cap, introduction of an independent auction monitor, ending the fixed price compliance option after 2021, the creation of a cost containment reserve and auction reserve price, limits on any future use of approved overseas units by participants, adjustment to the phase-down of industrial free allocation through 2050, introduction of “averaging” accounting rules for new post-1989 forest and a new “permanent forestry” activity, and coordination of decisions on unit supply and price management five years in advance with rolling annual updates. As a result of these reforms, the NZ ETS is now operating under its own cap on emissions for the first time since inception.

The first NZU auction was held on 17 March 2021. All 4.75 million units on offer were sold at NZ\$36 – slightly below the prevailing secondary market price at the time. In total, bids for 11.6 million NZUs were received from 40 participants. Subsequent auctions will be held on 23 June, 1 September and 1 December 2021.

Part of the reform package included putting a price on biogenic agricultural emissions, which account for nearly half of the country’s gross emissions. In amended legislation, by default, the price will be applied under the NZ ETS at the farm level for livestock and at the processor level for fertiliser no later than 2025. Output-based free allocation will begin at 95%. Under a Joint Action Plan with the government (He Waka Eke Noa), the sector has committed to prepare for farm-level emission pricing with a review of progress by the Climate Change Commission in 2022. If the sector’s progress is insufficient, the government may begin pricing agricultural emissions earlier than 2025 at the processor level. In addition, the government will report in 2022 on the option for an alternative farm-level system for pricing agricultural emissions.

In 2019, New Zealand enshrined in law a 2050 target of a 24-47% cut in biogenic methane below 2017 levels (including a 10% cut by 2030) and net-zero emissions of other GHGs. This amendment act also established an independent Climate

Change Commission which will, among other things, advise governments on five-year emissions budgets and emissions reduction plans and monitor progress towards the country's emissions goals. In June 2020, the government announced a provisional emissions budget of 354 million tCO<sub>2</sub>e for 2021-25; however, this could be revised following advice from the Commission due in mid-2021.

In April 2020, Minister for Climate Change James Shaw asked the Commission to review New Zealand's Nationally Determined Contribution (NDC) under the Paris Agreement and assess if the NDC should be revised to make it compatible with global effort to achieve the 1.5°C temperature goal. Any revision could have implications for future ETS settings. In its draft advice, the Commission found that the NDC would need to reflect a reduction in net emissions of much more than 35% below gross 2005 emissions by 2030 to be compatible.

## MARKET COMMENTARY



**FIGURE 1**  
NZU closing prices  
Source: Carbon Match

In the absence of long-term policy certainty on unit supply and given a large participant-held stockpile of NZUs (equal to about three years of surrender volume as of June 2020), market participants have previously been setting the NZU price guided by the fixed price option and expectations for increased mitigation ambition under New Zealand's 2030 and 2050 targets. The use of the fixed price option increased dramatically in 2018 as participants took advantage of the opportunity to bank NZUs freely allocated or earned from forestry removals which could be worth more than NZ\$25 in the future.

Emission prices responded to policy signals in the Zero Carbon Bill and Emissions Trading Reform Bill, but overall remained close to the level of the fixed price option from late 2018 until mid-2020. NZU prices rose above NZ\$30 in June 2020 after the government announced future changes to the fixed price option and unit supply, and continued to trade up as high as just above NZ\$39 during the period through March 2021. The inaugural auction in March 2021 cleared at NZ\$36, compared with a pre-auction secondary market price of NZ\$38.75.

The regulations on unit supply and price management settings adopted after passage of the ETS Reform Bill may be subject to change after the government receives the final package of advice from the Climate Change Commission on emissions budgets through 2035 and the first emissions reduction plan through 2025, due in May 2021. As detailed above, the Commission's draft advice provided for a more ambitious emissions budget trajectory than provisionally adopted by the government – implying downward adjustment of the previously announced ETS caps through 2025 – as well as more ambitious price control settings.

## USEFUL LINKS

[New Zealand Emissions Trading Register](#)

[New Zealand Climate Change Commission](#)

[Climate Change Response Act 2002](#)

[Climate Change Response \(Emissions Trading Reform\) Amendment Bill](#)

[NZ ETS Auctions](#)

## REFERENCES

[New Zealand Emissions Trading Scheme](#) – Ministry for the Environment

[Overview of the New Zealand Emissions Trading Scheme Reforms](#) – Ministry for the Environment

[A Guide to the New Zealand Emissions Trading Scheme](#) – Motu Economic and Public Policy Research

[New Zealand's Fourth Biennial Report under the United Nations Framework Convention on Climate Change](#) – New Zealand Government

[Climate Change Response Act 2002: 2018 New Zealand Emissions Trading Scheme Report](#) – Environmental Protection Authority

[New Zealand Emissions Trading Scheme: Facts and Figures 2018](#) – Environmental Protection Authority

[New Zealand Government 2 June 2020 press release](#)

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