

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	Currently no cap, although pending reform legislation will introduce a cap that will bind auctioned NZ Units (NZUs) and approved overseas units used by participants (if allowed in future). The government has signalled a cap to be set in regulations of 160 million tCO ₂ e over 2021-25, with zero overseas units. This could be modified in 2022 following advice from the Climate Change Commission.
Target(s)	Under the Paris Agreement, New Zealand committed to a 30% cut below 2005 levels by 2030, although this is subject to review by the independent Climate Change Commission. The country has legislated for 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.
Emissions Reduced to date	Pre-pandemic, the NZ ETS was projected to reduce net 2020 emissions by 2.9 million tCO ₂ e (annually).
Sectors covered	<ul style="list-style-type: none"> • Forestry (mandatory for deforestation of pre-1990 forest land; voluntary for post-1989 afforestation) • Liquid fossil fuels • Stationary energy • Industrial processes • Waste • Agriculture (reporting only) <p>Under pending reform legislation, 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 ₂ , methane, HFCs, N ₂ O, PFCs and SF ₆
# of covered entities	<p>As of June 2019, there were 275 mandatory participants (of which 75 are agricultural processor entities with reporting obligations only) and 2134 voluntary participants (of which 2106 conduct post-1989 forestry).</p> <p>Under pending reform legislation, unit and reporting obligations will apply to farmers for livestock emissions unless an alternative pricing mechanism is adopted.</p>
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>Pending reform legislation will introduce auctioning, adjust the phase-down of industrial free allocation, and provide output-based free allocation for biogenic agricultural emissions once surrender obligations apply.</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. Under pending reform legislation, 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. Under pending reform legislation, this will increase to NZ\$35/t for emissions in 2020 and (if applicable) any subsequent full calendar year(s) before auctioning starts. Reform legislation will enable a cost containment reserve and an auction reserve price. The government has signalled that, in regulations, the auction reserve price will start at NZ\$20/t in 2021, while the cost containment reserve will release a fixed volume of NZUs into auctions if the unit price reaches a trigger price starting at NZ\$50/t in 2021. Both thresholds will rise by 2% annually.</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	Failure to surrender units incurs a penalty of NZ\$30/unit plus a requirement to surrender the missing units. Failure to comply with administrative requirements carries a fine. Knowingly providing false information carries a larger fine and/or a prison term. Under pending reform legislation, the penalty for failure to surrender units will increase to three times the market price plus the surrender requirement and adjusted penalties will apply for other types of infringements.
Use of revenues	No auction revenue to date; revenue from the fixed price option is returned to the Crown account. Under pending reform legislation, future auction revenue will be returned to the Crown account.

MAJOR DEVELOPMENTS

Legislation to reform the NZ ETS was introduced to Parliament in October 2019. The legislation is to enact reforms arising from the 2015/16 review of the NZ ETS and subsequent public consultation. Key changes include introducing auctioning under a limit, introducing an independent auction monitor, placing an end date on the fixed price option, enabling a cost containment reserve and auction reserve price, limiting any future use of approved overseas units by participants, adjusting the phase-down of industrial free allocation through 2050, introducing “averaging” accounting rules for new post-1989 forest, introducing a new “permanent forestry” activity, and coordinating decisions on unit supply and price management five years in advance with rolling annual updates. As a result of these reforms, the NZ ETS will operate under its own cap on emissions for the first time since inception.

The Environment Select Committee published its report to Parliament in early May 2020, proposing adjustments including clarifying that the NZ ETS is to support the country’s Paris Agreement and longer-term goals, and deferring major forestry-sector changes from 2021 to 2022. In early June, the government announced it would delay the forestry changes until 2023 and extend the fixed price option to apply to emissions in 2020 and (if applicable) any subsequent full year(s) before auctioning starts, at an increased rate of NZ\$35/t. This will enable a transitional overlap between the fixed price option and the operation of a new cost containment reserve once auctioning begins.

Part of the reform package includes putting a price on biogenic agricultural emissions, which account for nearly half of the country’s gross emissions. In the reform bill, 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, 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. As part of this amendment act, an independent Climate Change Commission was established 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 tCO₂e for 2021-25; however, this could be revised following advice from the Commission due in 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 consistent with the global 1.5°C temperature goal. Any revision could have implications for future ETS settings.

MARKET COMMENTARY

In the absence of long-term policy certainty on unit supply and given a large participant-held stockpile of NZUs (equal to about four years of surrender volume as of June 2019), market participants have 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 \$25 fixed price option from late 2018 until mid-2020. Emission prices rose in June 2020 after the government announced future changes to the fixed price option.

In late 2019, the government began consultation on regulations defining auctioning rules as well as settings for ETS unit supply and price management over 2020-25. Its initial proposals were modified following consultation and the course of the COVID-19 pandemic. In June 2020, the government announced its intentions for the regulations to follow enactment of the reform bill. Key decisions included:

- The introduction of quarterly auctioning with a preferred start date of March 2021
- An auction volume of 90 million tCO₂e over 2021-25 (which does not account for entry of the agriculture sector in 2025)
- A limit of zero on approved overseas units over 2021-25
- An auction reserve price starting at NZ\$20/t in 2021 and rising 2% per year for inflation
- Addition of a technical reserve price whose value will be confidential to government and set in relation to secondary market prices
- A cost containment reserve volume of 35 million tCO₂e over 2021-25, with a trigger price starting at NZ\$50/t and rising 2% per year for inflation.

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 its first package of advice from the Climate Change Commission on emissions budgets and emissions reduction plans (due no later than August 2021).

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](#)

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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