

Submission

by

**Sustainable
Business Council**

 wbcSD Global Network Partner



to

Ministry for the Environment

on the

Emissions Trading Scheme Review

February 2016

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NZ EMISSIONS TRADING SCHEME REVIEW
SUBMISSION BY SUSTAINABLE BUSINESS COUNCIL

1.0 Introduction

Climate change is one of the defining issues of our time. Businesses here and around the world are transforming how they operate so they can successfully transition to the low-emission economy.

The New Zealand Emissions Trading Scheme (ETS) has an important role in reducing emissions in New Zealand. Business believes markets are the best approach to managing emissions and determining a price for these.

Over the past few years the ETS has not had the settings applied to drive a reduction in emissions. We are meeting our international obligations through international offsets, but domestically our emissions have continued to increase. The changes proposed in this ETS Review, while increasing incentives for the forestry sector, won't necessarily lead to the economic and business transformation needed in other key areas.

This is a concern for many businesses. SBC would like to see the ETS become one of a number of comprehensive and ambitious domestic approaches. To avoid global warming of 2°C or more and the risks associated with that scenario, we need to stem the rise in greenhouse gas emissions in order to achieve net zero emissions by the second half of the century and reduce gross emissions domestically. Our members want to see an operating environment that supports business transformation (so we can operate effectively in an emissions-constrained world in the future) while finding the most emissions-efficient producers of products and services globally.

Our members are committed to working with government to identify a comprehensive set of responses to climate change that will decouple economic and emissions growth. In doing so, we will need to carefully balance the short-term and long-term implications of change – both the positive and negative aspects.

This ETS review is timely. It has been several years since the global financial crisis ended and we now have an international agreement on climate change which presents a strong signal on the future direction of travel. But looking at the ETS alone is not enough - it is a good time to be thinking about New Zealand's overall response and the benefits and opportunities New Zealand can gain from taking action.

This submission sets out:

- SBC's principles for action on climate change
- Opportunities for government action beyond the ETS that will have the biggest influence on transforming New Zealand's economy
- A business view on what an ideal ETS looks like
- Some potential pathways to reach the ideal ETS

2.0 About the Sustainable Business Council

SBC is an executive-led group of companies that advocates a better way of doing business, to create a sustainable future for New Zealand. We provide a platform for collaborating on business solutions and enable our members to be leaders in sustainable practice. We do this because businesses can only be successful in the long term when people live well and within the limits of the planet.

The Sustainable Business Council has 84 members, including a number of New Zealand's largest companies, representing a wide range of sectors. Their collective turnover is around \$72 billion or about a third of private sector GDP. Our council members are senior executives and decision-makers. All members have made a commitment to the balanced pursuit of economic growth, ecological integrity and social progress within a business context and to report on their progress.

SBC is a division of BusinessNZ and the New Zealand global network partner to the World Business Council for Sustainable Development (WBCSD). WBCSD is a CEO-led coalition of forward-thinking businesses. It has global network partners in 66 countries and has been an influential global voice for business on climate change through its work on the Low-Carbon Technology Partnership Initiative and its work with the We Mean Business coalition on climate change.

About this submission

This submission was developed based on a survey of members conducted in 2015, conversations with a wide range of SBC members and an SBC workshop attended by 48 member representatives. The submission has been approved by a sub-group of business leaders and mandated by the full SBC Advisory Board.

SBC has received broad endorsement from members for the submission. Members diverging on key points have endeavoured to submit independently so their unique challenges and opportunities are heard in the ETS Review process.

3.0 Where we are now

3.1 The global context for business

Recently the New Zealand Government signed two ground-breaking global agreements that signal a strong will to tackle rising global temperatures. They are the COP21 Paris Agreement and the UN's Sustainable Development Goals (SDG 13). New Zealand's commitment to both of these is welcomed by SBC. Globally and domestically, business is playing a much more active role in addressing climate change. Business was influential in the development of both the Paris Agreement and the SDGs.

Businesses worldwide are moving ahead quickly to address climate change. SBC's international partner WBCSD has identified substantial long-term economic benefits from transitioning to a low emission economy. The transition is expected to require a rapid increase in investment with demand for technology, construction and new capability and expertise having the potential to create a huge opportunity for businesses to add value and support employment. Globally, WBCSD's member businesses are actively working on addressing climate change, including working with multiple countries on its Low Carbon Technology Partnerships Initiative and its Climate Smart Agriculture programme.

Elsewhere, both China and the United States are pushing ahead with a number of significant actions to address emissions. The World Economic Forum's annual risk survey for 2016 identified the failure to deal with and prepare for climate change as the biggest single threat facing the world economy.

3.2 Business action

Many of New Zealand's largest companies are actively managing their own emissions and finding new opportunities, cost savings and efficiencies as a result. Some of our biggest emitters are driving innovation, trialling and introducing new technologies. For example, Air New Zealand is upgrading its fleet of planes as it aims to be the most fuel-efficient commercial fleet in the world and this month Z Energy will launch New Zealand's first commercial scale biodiesel plant. These are just two of many examples.

Businesses are working together on key areas including: sharing best practice leadership on climate change adaptation and mitigation; exploring how to assist consumers to make low-emission choices; collaborating on low-emission transport; improving energy efficiency; and improving urban infrastructure so it is both resource-efficient and resilient. (See [Climate Change Action: Business Brief for Paris](#) for more detail).

Member businesses are also in the process of identifying the systemic change needed for New Zealand businesses to support a goal of net zero emissions and a reduction in gross emissions within New Zealand in the long term.

3.3 New Zealand's unique challenges and opportunities

We have a unique emissions profile for a developed country with a large proportion of emissions coming from sectors where there is limited existing technology that can easily address this, for example, agricultural emissions and parts of our industrial sector.

We are a highly efficient agricultural producer by world standards and a significant investment is going into research to reduce methane emissions. However we are some years away from a solution.

Despite the global financial crisis ending some years ago, challenging economic conditions remain for parts of our industrial sector. In addition, the capital cost of transformation to a

low-emission economy will in some instances be significant. For example, the cost of retiring and transitioning assets with decades-long life spans is likely to cost billions of dollars.

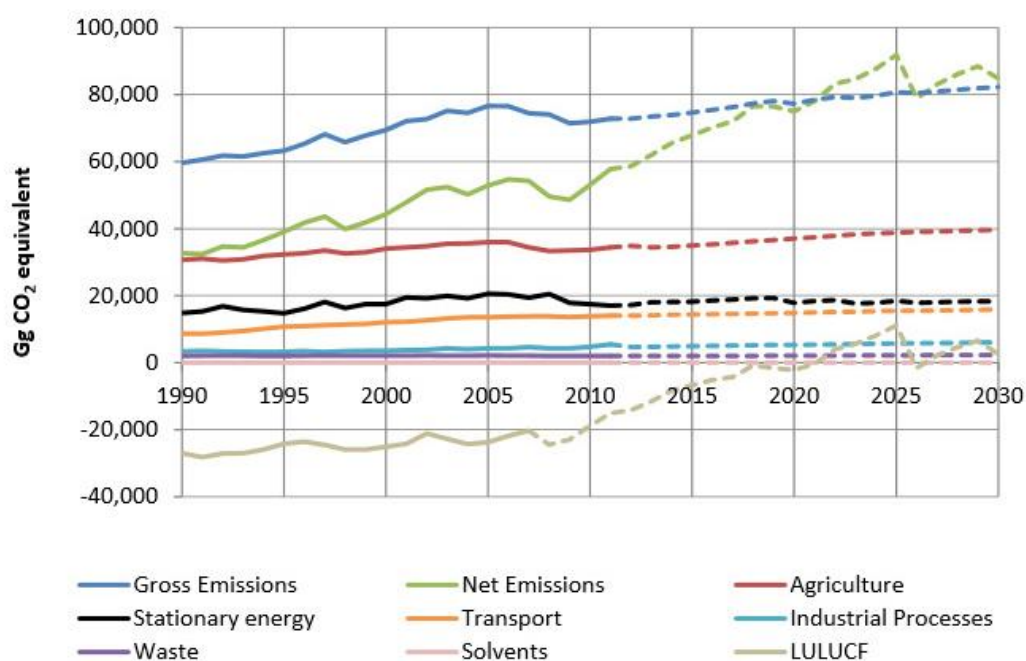
Forests planted in 1990 have played a key role in offsetting emissions. But New Zealand won't be able to rely on forests as its sole means of reducing emissions – it needs to be hand-in-hand with business transformation to achieve a reduction in gross emissions over time.

In New Zealand we have significant access to renewable energy – something that will be in high demand in future.

3.4 Our level of ambition

Former climate change Minister, Tim Groser, indicated that New Zealand is likely to face continually increasing ambition in its international climate targets. But projections show that under our current settings gross emissions are not expected to fall.

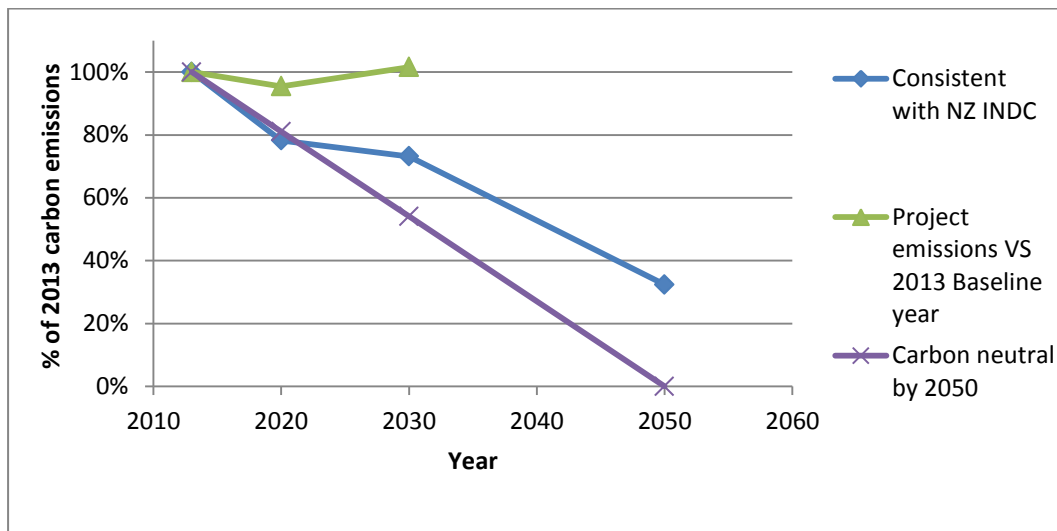
NEW ZEALAND'S ACTUAL AND PROJECTED EMISSIONS



Graph 1 New Zealand's actual and projected emissions 1990 – 2030 under the UNFCC. Source: MfE's Sixth National Communication under the UNFCCC and the Kyoto Protocol, 2013. NB: Gross emissions exclude the LULUCF (forestry) sector.

Analysis shows that to achieve the 2030 target without international offsets would require businesses to make an emissions reduction, relative to 2013 of about 1.6% per year with about 1.8% per year to meet the 2050 target.

PROJECTED CARBON EMISSIONS VS PATHWAYS TO ACHIEVE INDC TARGETS & CARBON NEUTRALITY



Graph 2: New Zealand's projected emissions versus path to achieve INDC targets and carbon neutrality relative to 2013 emissions

4.0 A series of domestic actions is needed

(Relevant to Q1, 2, 26, 27)

SBC welcomes the ETS Review carried out by the Ministry for the Environment. The ETS should play a crucial role in New Zealand's successful transition to a low-emission economy. However, it needs to be one of a number of domestic actions taken. It cannot be the only response.

SBC members want to see an ambitious pathway established so all parties – business, government and civil society - can move towards a common goal.

Post-Paris there are significant risks if New Zealand does not do more to address climate change. These include: Ongoing and lengthened uncertainty for business; damage to New Zealand's credibility and brand; reduced competitive advantage, with New Zealand unable to position itself as an innovator and leader; and reduced capability and professional talent in low emission technologies within our workforce.

These risks sit alongside the global environmental and social risks caused by rising temperatures, like social unrest internationally, sea level rises here and in the Pacific, health issues, and the impact of extreme weather events on infrastructure, tourism and the agriculture sector.

Emissions reductions in all sectors are more likely to be achieved if we have coherent, predictable government policies across a number of portfolios (energy, transport, agriculture, infrastructure) that match the new global ambition. Efforts to support the path towards a global price that is set by linked emissions markets will strengthen this.

4.1 Principles for decision-making on climate *(Relevant to Q26, 27)*

SBC members want to see a consistent approach to managing climate change. New Zealand needs a clear path that shifts us towards a net zero emission economy and includes a reduction in gross emissions domestically over time.

This goal could be supported by adopting a set of principles:

- Ensure there is an effective cost on emissions, capable of stimulating behaviour change
- Accelerate the uptake of clean technologies
- Continue to develop an international business brand: clean, green, safe and climate-friendly
- Maintain New Zealand's international competitiveness
- Keep moving forward (no backwards steps)
- Signal early and act consistently

There are tensions within these principles that will need to be managed carefully, and in close consultation with business. For example, how we ensure emissions trend down while retaining international competitiveness; and how we keep moving forward fast enough to achieve ambitious targets without hurting the economy. We need to keep an open and constructive dialogue with representatives from across the spectrum of businesses as we move forward.

4.2 Setting the direction *(Relevant to Q1, 2, 9, 26, 27)*

There is more that government can do beyond the NZ ETS to support business to move faster and to go further to address emissions. This includes:

4.2.1 Signalling an ambitious direction of travel and having clear and unambiguous policy to achieve it: This ETS Review process and the actions government commits

to as a result is one important tool for signalling an ambitious direction of travel. We note that many of the transitional measures in the ETS remain in place despite previous reviews recommending otherwise. This includes removal of the 'one for two' obligations and the inclusion of agriculture emissions in the scheme. We do not believe that retaining status quo in 2016 will send the right message about government's commitment to addressing emissions. Decisions on how we move forward needs to be the result of an ongoing conversation with a range of businesses.

4.2.2 Taking an apolitical and cross-government approach to addressing climate change: There is an opportunity to set out a clear direction for achieving the goals New Zealand has committed to as part of both the Paris Agreement and the Sustainable Development Goals (SDG13).

Members have said they would like to see cross-party political agreement on the targets and on the approach to achieving them. In addition, there is potential to improve collaboration and co-ordination across government agencies consistent with the Better Public Services approach to joined-up government and in supporting the Business Growth Agenda. This should involve setting up a group of Ministers supported by senior officials from key government agencies including transport, environment, primary industries, treasury and business, innovation and employment.

4.2.3 Support innovation in low emission technologies: There are more opportunities for the government to support growth in low emission technologies in a range of ways. This could include through grants, by awarding ETS units to companies developing low carbon technologies or recycling additional revenue from the shift to full surrender obligations into encouraging low emission initiatives. Government has an opportunity to consider implementing an investment approach to climate change which could support faster commercialisation of new technologies and help New Zealand position itself as a world-leader in climate-friendly products and services.

4.2.4 Central and local government demonstrating leadership in procurement: Considering emissions impacts as a priority in procurement guidelines will send a strong signal that government is serious about addressing climate change. Transport and infrastructure are two areas that could benefit from a government focus on procurement in the short term.

Knowledge of the emission impacts of products and services is growing though the employment of Life Cycle Assessment methodology and Government engagement with this would help embed the process in the economy.

4.2.5 Effective ongoing engagement: SBC would like to see government continue to work closely with key industry sectors that are developing their own targets, strategies and enablers to transform the way they work. Business will be essential in providing the innovation and planning to move through technological uncertainty. Government will have an important role providing the information needed to drive good decision-making.

Business leaders need to be closely involved as they have the ability to play leadership roles in key elements of the change needed. That is already starting to happen on targeted pathways where there is economic and environmental alignment (e.g. freight efficiency, energy efficiency, electric vehicles etc). There is more we can do with strong relationships and continued dialogue.

Government engagement is particularly necessary with the Emission Intense, Trade Exposed (EITE) group of businesses where, by nature of their significant emissions profile and the settings of the allocation process, their businesses are most able to make significant emission reductions if technological innovation is encouraged or enabled.

SBC looks forward to working with the Government in these important areas. SBC will continue to provide recommendations on where Government policy and action can support and accelerate this.

4.3 Further considerations

New Zealand businesses will be pivotal in supporting a successful transition to a low-emission economy. As noted earlier, business will go further and faster if the right government signals are in place with the right mix of policies. Any action the government commits to needs to be evidence-based and promote actual reductions in emissions and is hand-in-hand with business.

Business needs to better understand the costs of action *and* inaction on climate change: For example, the likely impact on tourism if New Zealand's reputation is damaged by rising emissions levels; the benefits to agriculture of New Zealand taking a lead on climate change; or the economic risks from consumer behaviour change, new innovations and technology.

Some members would like consideration around mandatory reporting of emissions by businesses. This could happen, for example, through the GHG Protocol which provides standards and guidance for greenhouse gas accounting and reporting.

Members also believe there is more that could be done to support consumer awareness and behaviour change. This is an area that our members are already exploring independently.

5.0 Changes to the NZ Emissions Trading Scheme

SBC members support a market-led emissions price set through the ETS and believe it will have an important role in helping New Zealand to reduce emissions in the long-term. The role of the ETS is to create a market that, by putting a price on emissions, encourages business decisions that find the most emission-efficient responses and transforms businesses.

A number of SBC members would like to see New Zealand demonstrate more ambition over time. Their view is that New Zealand needs to have its own shop in order to maintain its competitive advantage and its international credibility.

5.1 What does an 'ideal ETS' look like?

SBC would like to see the government continue to move towards an ideal ETS. In our view, the key characteristic of an ideal ETS are:

- Full obligations – everyone paying for a tonne. All sectors, all gases, no free units
- Some restriction on access to international markets with credible units, for example a restriction of 50%
- An absolute cap on emissions (i.e. a New Zealand emissions budget)
- Auctioning – to find an economy-wide cost curve
- No price floor or cap with the market-determining price

It should be noted that no country has a trading scheme that meets this ideal yet.

5.2 Moving towards the common goal – an 'ideal ETS' (*Relevant to Q3, 4, 5, 6, 7*)

The majority of SBC members agree that we will need to move to full surrender obligations at some point in the near future. Doing this will send a strong signal to business that government is serious about moving closer to an 'ideal ETS'. The removal of the 1 for 2 surrender as a transitional measure has now been signalled for some years. Inaction risks sending a counter signal – i.e. that government is not serious about addressing climate change. In addition, removing the one for two surrender obligation will provide a boost to the forestry sector which currently acts as an important sink for New Zealand emissions. Some members would like to see this happen immediately, other members think it should be conditional on our alignment with international markets.

Regardless, moving to full surrender alone will not be enough to tighten supply in New Zealand and support transformation in the economy. We also need to consider a range of other actions that will reduce the domestic supply of emissions units over time. How this is achieved will need to be carefully managed to ensure that international competitiveness is maintained.

We would also like to see the government:

5.2.1 Introduce auctioning and signal intention to restrict supply of international units (*Relevant to Q17, 18*)

The shift to full surrender obligations should come hand-in-hand with the introduction of domestic auctions to ensure there is a supply of units in the short term beyond those from the forestry sector. Any revenue generated by auctioning could be fed into low emission technology projects.

At the same time, the government should *signal* an intention to restrict supply of international credits. We would like to see the ETS opened up to international markets at the earliest possible time but with a restriction on credible emissions

units that are able to be purchased offshore. For example, a 50% restriction on international units could be introduced to ensure there is a clear expectation that domestic emissions need to reduce. We propose working with government on what the right balance of domestic versus international access would look like.

5.2.2 Consider introducing an absolute cap on emissions within the scheme:

We would like to see government work with business on how to introduce an absolute cap on emissions. By setting a base year for emissions, the government could then outline direction for achieving an emissions reduction. This would give our ETS more credibility offshore and provide an incentive to transition the domestic economy.

Although the 2020 and the 2030 targets set by the Government could be achieved through purchase of international units alone, we do not think this will lead to the business transformation necessary. Lack of action on domestic emissions will bring with it a number of risks. In setting an absolute cap on emissions, the government would need to work closely with business, particularly emissions intensive and trade exposed businesses to manage the potential impact.

5.2.3 Consider introducing a continually rising corridor (a floor and cap) on unit prices as a transitional measure: (Relevant to Q6, 7, 8, 20, 21, 22)

Under the ideal ETS there would be no price floor and no price cap. Having a cap on prices means the market may not be paying for the true cost of emissions.

If the government does not intend gradually removing the price cap in the short term it could instead consider introducing a price corridor as a transitional measure. The benefit of introducing a gradually rising price cap and floor is the price certainty it brings as it reduces the potential for price shocks. Introducing a price corridor would also see us continue to move forward in addressing emissions over time, particularly during the period when international markets are still being developed elsewhere around the world. Government will need to work closely with business for this approach to work. We propose removing the price corridor altogether as soon as the conditions are right: for example, when the ETS has adequate links with stable international markets.

5.2.4 Consider the conditions for including all emissions within the ETS (Relevant to Q11, 12)

The emissions market will not function in the best possible way until all emissions are included. However, there are recognised challenges with introducing agricultural emissions into the ETS including the potential impact on future growth of the agriculture sector, the implications for food security and concerns around international competitiveness.

A recent economic report released by Westpac - *The Paris Agreement: What it means for the New Zealand economy* - identifies that by excluding agriculture from emissions obligations the financial burden of biological emissions is passed on to other businesses and households. Ultimately this means either tighter targets for industries with emissions obligations (energy, landfills, industrial processes and forestry) so that agriculture can continue to emit, or the Government has to purchase carbon units to pay for agriculture's emissions at added cost to the taxpayer.

SBC members have a range of views on this topic. Some members want to see biological emissions brought into the ETS immediately so that we are not passing on

the cost of those emissions to future generations. Others have raised concerns about the impact of not having a level playing field on their own businesses. A further group believes that biological agriculture emissions should continue to be excluded until adequate technological solutions are in place and there is alignment with competitors internationally.

Now is the right time to have a careful and considered conversation about whether emissions from agriculture should be included, over what timeframes and under what conditions. If inclusion is likely, then clear timeframes need to be set and adhered to. This will provide the wider business community with the certainty it needs for future investment decisions.

5.2.5 Set out a timeframe or key conditions needed to phase out free allocation

The Emission Intense, Trade Exposed (EITE) allocation of units is designed to protect New Zealand business while other jurisdictions, notably our trading partners, establish an equivalent cost of carbon in their own economies.

SBC would like to see the government prioritise work that establishes how we evaluate comparative costs of carbon across other economies and how we can carefully coordinate the dismantling of any protections in unison.

We would like to see government work closely with business on what that framework would look like, the right timeframes and what conditions needed to achieve the timeframes set.

5.2.6 Reopen NZ ETS to international markets as soon as possible *(Relevant to Q16)*

New Zealand needs to align with international carbon trading markets so that we can establish an effective global market that identifies the lowest emission producers of goods and services.

However, unrestricted access to international credits could mean that incentives to transition our domestic economy are weakened. We would like to see the NZ ETS opened up to international markets at the earliest possible time, with a restriction to access of credible emissions units purchased offshore (see point 5.2.1).

Urgent work needs to be done to identify credible international units (so that New Zealand only accepts a gold-standard for international units for trading) so we can re-open the ETS to international units as early as possible.

In addition, New Zealand should remain flexible to the changing international environment and progression of international emissions trading rules so, over time, we can align with other successful trading schemes. For example, a recent WBCSD and World Forum report identifies potential for the formation of climate-clubs and coalitions.

5.3 Identifying the conditions needed

As we transition towards an 'ideal ETS' we need to take care to reduce any unintended consequences. The transition will see additional costs placed on some businesses and could see trade-exposed industries suffer from carbon leakage, meaning the emissions problem shifts from New Zealand to another country, potentially increasing global emissions overall. We would like to see government working closely with business to identify what are the right trade-offs to make and when. We also need to have a conversation about the pace of change that is right for New Zealand and what that looks like relative to other countries. The five yearly review of the INDCs which was agreed as part of the Paris Agreement may act as a good touchstone for this.

6.0 Conclusion

SBC members, who account for over a third of private sector GDP in New Zealand, are more ambitious than ever on what both business and government can do to address climate change. The majority of members have endorsed the common goal of shifting New Zealand to net zero emissions by some time in the second half of the century and to create a meaningful transition nationally through a gross reduction in domestic emissions.

The government needs to take actions that will move us closer to that goal, while managing our international competitiveness and ensuring we identify the most emissions-efficient producers of goods and services globally. Business believes that markets are the most effective way of achieving that. However, under the current settings, and with the short term settings under review, the ETS alone will not be enough to catalyse the sort of transformation we need.

Government can support the transformation further through both the actions it takes and the signals it sends. Key recommendations are for cross-party agreement and Ministerial-level coordination on climate change, plus strong business engagement and demonstrating leadership through government procurement.

We do not believe that tinkering with the current ETS settings will get us closer to our climate goal. However, we have set out options that would tighten the supply of emissions domestically. We urge government to work closely with business to have a deep conversation about the mix of options, their timings, our ambition and the balances we need to make to achieve the best outcomes. The sooner we have a more enabling environment to support action, the more we will be able to avoid the costs of transitioning to an inevitable low-emissions economy.

Our member businesses will go further and faster if the right government signals exist and the right mix of policies is in place.

APPENDIX: Table of responses by question

Context and drivers for the Review	1.	Do you agree with the drivers for the review?	Section 3
	2.	What other factors should the Government be considering in this NZ ETS review?	Section 3 & 4 covering the series of domestic actions needed
Full surrender obligations	3.	Should the NZ ETS move to a full surrender obligation?	See section 5 including 'An ideal ETS' (5.1) and 5.2 onwards
	4.	What impact will moving to full surrender obligations have?	
	5.	If full surrender obligations are applied, when should this be implemented?	
Managing costs of full surrender obligations	6.	If the NZ ETS moves to full surrender obligations, should potential price shocks be managed?	See section 5, including 5.2.3
	7.	If potential price shocks associated with moving to full surrender obligations should be managed, how should this be done?	
	8.	If the \$25 fixed price surrender option value should change, what should it change to and why?	
Other issues: business responses to the NZ ETS	9.	Do you consider the future cost of emissions in your business planning? Yes/No	N/A
	10.	What would improve your ability to take into account the future cost of emissions in your business planning	N/A
Other issues: protecting competitiveness through free allocation	11.	Under what conditions should free allocation rates start to be reduced after 2020	See 'An ideal ETS' (5.1) and 5.2.5
	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?	Refer to principles 4.1 and 5.2.5
Managing unit supply - forestry	13, 14, 15		N/A
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?	See 'An ideal ETS' (5.1), 5.2.6 and 5.3
managing unit supply – auctioning	17.	Should auctioning be introduced in the NZ ETS? Yes/No/Unsure If yes, when?	See 'An ideal ETS' (5.1) and 5.2.1
	18.	What should be the role or purpose of an auctioning function in the NZ ETS, if one were introduced?	A) to align with international
	19.	How should auctioned NZUs relate to other sources of unit supply in the NZ ETS, especially NZUs generated through forestry removals and/or international units?	N/A
Managing price stability	20.	What impact has carbon price volatility in the NZ ETS had on your business?	N/A
	21.	Do you think measures should be in place to manage price stability? Yes/No/Unsure	See 'An Ideal ETS' (5.1) and 5.2.3

	22.	What do you consider are important factors for managing price stability?	See 'An Ideal ETS' (5.1) and 5.2.3
	23.	What should the Government consider when managing price stability?	N/A
Other issues:	24, 25		N/A
Addressing barriers to the uptake of low emissions technologies	26.	Are there any barriers or market failures that will prevent the efficient uptake of opportunities and technologies for reducing emissions?	See Section 4
	27.	If so, is there a role for the Government in addressing these barriers or market failures and how should it do this?	See Section 4