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Improvements to the New Zealand Emissions Trading Scheme consultation document

The Ministry for the Environment

Submitted by email to etsconsultation@mfe.govt.nz

PEPANZ Submission *Improvements to the New Zealand Emissions Trading Scheme consultation document*

Introduction

This document constitutes the Petroleum Exploration and Production Association of New Zealand's (PEPANZ) submission in respect of the Ministry for the Environment's consultation *Improvements to the New Zealand Emissions Trading Scheme consultation document* for which submissions close on 21 September 2018.

PEPANZ represents private sector companies holding petroleum exploration and mining permits, service companies and individuals working in the industry.

Overarching comments

We support the ETS but consider competitiveness and carbon leakage are critical factors when making amendments

We support the role of the New Zealand ETS and consider that policies should enable efficient emission reductions and maintain international credibility, but strongly submit that the settings and outcomes they intend to achieve should be comparable with New Zealand's trade competitors.

The competitiveness of New Zealand firms and corresponding risks of carbon leakage should be foremost in mind when developing climate policy. The petroleum sector is a global and trade-exposed industry, which means cost imposts on goods which are either exported or face import substitutes cannot be simply passed on to consumers and therefore reduce margins. This is especially relevant to exported oil and natural gas (natural gas is exported from New Zealand after conversion to methanol).

We supported the Productivity Commission when it said in its report on the Low-emissions Economy of August 2018 (page 118):

> "A controversial effect of emissions pricing is raising the costs of domestic firms exposed to international competition from firms in other countries that face either a zero or lower price on their emissions.
>
> Possible negative impacts are:
>
> - domestic firms may not be able to compete or even be forced to close;
> - over time, production may re-locate and grow in countries without emissions prices; and

- global emissions may stay the same or even increase if production in other countries is more emissions-intensive than the lost New Zealand production. Further, such production shifts could be hard to reverse even after emissions price parity is reached in the other countries."

New Zealand petroleum production is susceptible to carbon leakage to jurisdictions that lack comprehensive emission taxes or trading schemes. Carbon leakage may shift production to nations with poorer standards, or that involve more emissions when produced and refined.

Stable settings are critical

We strongly support stable and predictable policy settings, and these are particularly important for the petroleum sector with its long lead times and significant capital and operating costs, especially in frontier basins with uncertain geological prospectivity such as New Zealand.

The need for policy stability is also critical in the ETS, so as to minimise market volatility and to provide confidence that reasonable assumptions about the future are broadly likely to hold.

Emissions markets are artificially created markets, which means that participants are concerned not only with the dynamics in the market itself, but also with framework of the created market and the approach of market-regulators. In introducing further policy change to the NZ ETS, it is important these are developed robustly with regard to the longer term and well signalled so as to mitigate uncertainty and volatility.

Arbitrary and unilateral decisions, such as the Government's announcement of 12 April 2018 to cease issuing offshore petroleum exploration permits, are extremely damaging to investor confidence throughout the economy, and should be avoided.

ETS policies should be developed in line with other domestic policies and the policies of trade-competitors

ETS policy should be developed in a way that is aligned with the Zero Carbon legislation and informed by the August 2018 findings of the Productivity Commission. How things fit together will be important, as will be the sequencing of policy implementation. Consideration of broader public policy developments will be critical too, for example, how will higher emissions pricing on top of new fuel taxes affect the competitiveness of firms and the well-being of households?

As mentioned in relation to carbon leakage risks, given the trade-exposed nature of the New Zealand economy and the importance of the competitiveness of firms, policies should in our view generally track those of the country's trade-competitors.

International units

Access to legitimate international units should be enabled, given the fundamental value of the ETS (compared to a simple carbon tax) is that it enables international trading to achieve efficient emission reductions at the lowest marginal cost and to draw on global price signals to distil dispersed information.

We strongly support the intention under the Article 6 of the Paris Agreement to establish bilateral or multilateral trading of credits. We understand this is on the agenda for the Conference of Parties in Poland in December 2018, and we encourage the New Zealand Government to advocate strongly for this. International units, if allowed in the New Zealand regime, will promote economic efficiency, price discovery, and ultimately increase market depth and liquidity.

Specific submission points

Question 5. Do you agree with the proposal that all NZ ETR account holders should be able to participate at auction? If not, why not?

Yes.

Question 11. Do you agree that the $25 FPO may not be appropriate for the short term, and may need to be adjusted before 2020? Please explain.

No. Unexpected change and short-term changes compromise stability that is critical to the regime, and arguably reduces confidence in future price signalling (if it perceived that such changes may similarly be undone at will).

Question 12. Which mode of purchase for international units (direct or indirect) would be the best approach for the NZ ETS, acknowledging that there are other significant factors that will influence this decision? Please explain.

We support the use of international units as outlined in our overarching comments. We consider that ETS participants should be able to directly purchase international units, and consider this will improve liquidity and lead to price discovery and in turn stability.

If the Government alone (and not other market participants) can purchase international units for subsequent auctioning, New Zealand firms would not necessarily be able to acquire units at a price comparable to our trade competitors.

Question 13. If NZ ETS participants are able to purchase and surrender international units directly, do you think that there is justification for varying the percentage of allowable international units by participant type? If not, why not?

No. This would introduce unnecessary central planning and bureaucracy into the system with no clear benefit and to address an unspecified problem. Apart from administering changes to EITE allocations in line with overseas policy developments, we prefer to avoid government control of how specific sectors are managed under the ETS.

The appropriate role of Government is to administer the regime as a whole without delving into sector issues.

Question 14. How do you think decisions on a phase-down of industrial allocation should be made? Select all that apply.

Any removal of free allocation should be in line with relevant international developments among trade competitors rather than any arbitrary timelines. Free allocation should only be reduced when the international conditions are such that carbon leakage from New Zealand is no longer a material risk. The rate at which carbon leakage risk declines will be determined by dynamic global factors and so free allocation to trade-exposed industries in New Zealand should remain appropriately benchmarked.

It is difficult to judge at this time how global policy settings will evolve over coming years and we are mindful that previous expectations of international policy development in the emissions trading area have not been realised. A pre-determined rate of reduction in free allocation levels risks creating a significant distortion in the international competitiveness of affected businesses, unless it happens to coincidentally align with the pace at which obligations are applied globally.

Given that emissions pricing appears likely to emerge on a jurisdiction by jurisdiction, or regional basis, rather than being imposed globally at one time it will be important to consider developments in relevant markets. A particular challenge is that different sectors will be exposed to competitors in different markets, which will likely impose varying policies. This raises the potential for any phase out to occur for different sectors at different times, aligned industry by industry to the level at which those industries globally incorporate a price on emissions.

The focus should be on the development of suitable metrics based around the extent of global emissions covered by emissions pricing in other jurisdictions (at an economy and sectoral level) and comparable effort, in terms of GDP per capita or some other appropriate metric, as opposed to arbitrary time triggers.

Question 15. If a decision-making process for industrial allocation is implemented, which of the following factors should the decision-maker take into account?

- **emission budgets**
- **the risk of emission leakage, with the aim of avoiding leakage driven by differential emission pricing policies, and based on economic analysis of the markets for EITE activities and their products**
- **other sources of supply into the NZ ETS**
- **the availability of low-emissions technologies**
- **New Zealand's international obligations**
- **other (please explain).**

We consider that the above factors may all be relevant, but submit that consideration of emission budgets must be balanced by the other items listed.

We recommend including the treatment of EITE sectors by trade-competitors as another factor.

In addition, it is important to consider the value of EITE sectors (such as methanol production in New Zealand) in underwriting the domestic gas market (by consuming large amounts and providing stable demand, which enables upstream producers to confidently make investment decisions) should be considered. This is important because relatively low-emissions natural gas, which backs up the electricity supply and which is used commercially, supplied and kept affordable on the basis of this effective underwriting.

Question 16. If a phase-down is initiated in future, which of the following rates for phasing-down industrial allocation should be considered?

- **0.01 per year**
- **0.02 per year**
- **0.03 per year**
- **Other (please explain).**

We do not consider a pre-determined rate is appropriate. This is because of most relevance is the action of our trade-competitors, so reduction in EITE allocation could match that to incentivise emission reductions while not compromising the competitiveness of domestic firms.

Question 17. What impact would changes to the levels of industrial allocation from 2021 have on your investment or business decisions?

The oil and gas sector supplies natural gas to NZ EITE consumers. Reducing EITE allocation at a pace faster than that of trade competitors would compromise that customer base which in turn affects the upstream producer. This may lead to upstream producers and EITE downstream consumers, many of which are multinational, relocating production to less restrictive jurisdictions.

Question 19. Do you think that there would be benefits from publishing individual emissions data reported by NZ ETS participants? (Please explain.)

No, because with the upstream point of obligation that the ETS employs, producers of oil and gas would nominally be over-represented in their contribution to the emissions profile, even though the vast majority of emissions arise when hydrocarbons are burnt by the end consumer. We note that large downstream consumers can 'opt-in' to the ETS to take on the obligations, but this is not required.

Question 21. How would publishing these types of information impact you?

Unless all downstream consumers 'opt-in' to take the surrender obligations, publishing this information would portray upstream oil and gas producers as contributing more to emissions than they do. This would misrepresent the upstream sector's ability to manage, mitigate, or offset emissions as well.