



Hon James Shaw
Minister of Climate Change
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Tēnā koe Minister Shaw

I'm writing to you, and to other members of the Climate Response Ministerial Group, about the advice that He Pou a Rangi Climate Change Commission submitted in March this year to you, as the Minister of Climate Change, on the unit limits and price control settings for the New Zealand Emissions Trading Scheme (NZ ETS settings) for the 2024-2028 period.

Cabinet's next consideration of the settings is soon approaching. I recognise this will be a challenging decision given cost of living and other pressures facing the country right now. Successive Governments will be confronted with many difficult decisions as they steer the country through the risks and impacts caused by climate change. Staying committed to climate action is required to reap the benefits of a sustainable, low emissions and climate resilient economy in the future.

The Commission gives NZ ETS settings advice every year, as part of the annual process to keep the scheme's regulations up to date. The advice relates to unit limits (quantities), which aim to cap the emissions from NZ ETS sectors, and price control settings, which are intended as guardrails for the market while also enabling it to operate as an effective tool to reduce emissions.

In summary, the Commission's 2023 NZ ETS settings advice recommends:

- reducing the limit on the number of units available for auction
- raising the trigger prices for the cost containment reserve and auction reserve price
- changing to a two-tier cost containment reserve.

The analysis that underpins this advice is largely the same as last year, so our recommendations are similar to those in our 2022 NZ ETS advice for the 2023-2027 period.

While the Government decided to mostly follow our 2022 advice on unit limits, it maintained status quo price control settings which were significantly lower than our recommendations. This indicated a low price and likely high volume preference over the medium term, not just in the coming year.

In this year's decision on the NZ ETS settings, I urge you to consider how choices now will have consequences for the future. A choice to maintain the status quo will contribute to a weak NZ ETS. The Government, now and in the future, will likely need to impose other regulations or policies to compensate for an NZ ETS that cannot play a substantial role in lowering domestic emissions.

Cost of living is a major concern for New Zealanders right now, and at the same time we cannot afford not to take climate action. The costs associated with delayed action to adapt to our changing climate are escalating and it is becoming increasingly obvious that high emissions lifestyles and sectors are susceptible to disruption. Deferring necessary decisions is not sustainable in the long run.

Since the NZ ETS is a market created by the Government, Government decisions are critical for shaping market sentiment and the scheme's effectiveness at driving emissions reductions. If the Government's intentions or commitment to climate policy and the NZ ETS are unclear, this leads to volatility in the emissions price. Volatility makes it difficult for emitters to plan and makes investments to reduce emissions riskier, more expensive and delayed.

Following the announcement of the Government's last decision on NZ ETS settings in December 2022, the spot price of New Zealand Units (NZUs, the unit of trade in the NZ ETS) immediately weakened. The NZU auctions in March and June this year were declined, with bids not fulfilling minimum requirements for the auctions to clear. As of today, the NZU spot price is sitting at \$39, having more than halved in value from a high of around \$88 in late November 2022.

I believe, as do many others who have commented on the issue, that this indicates a loss of confidence by market participants in the Government's commitment to climate action and to the NZ ETS. While the Government's first emissions reduction plan recognises the central importance of the NZ ETS to Aotearoa New Zealand's efforts to decarbonise, it now appears that the Government is not prepared to follow through and operate the NZ ETS accordingly.

If the Government adjusts NZ ETS settings in line with our advice this year, I believe it could restore some confidence to the market, although ongoing uncertainty about the Government's plans for the NZ ETS will remain an issue. The higher trigger prices for the price controls would at least give the scheme the room needed to contribute to reducing gross emissions, so that emissions budgets and targets can be met in a sustainable way.

The key intended impact of emissions pricing is to reward choices that reduce emissions. Households and businesses who switch to low emissions options reduce their exposure to the emissions price and will likely reduce their overall costs.

Not everyone is able to do this, but targeted assistance for those who need it is a better option than not acting as quickly as we can to lower emissions. The Government has an existing suite of tools in the tax and welfare system that can be used to manage household impacts, and the opportunity to deploy new ones such as a potential carbon dividend.

Emissions prices that signal the value of lowering emissions over time matter. The NZU price is a key driver of emissions reductions in some sectors – particularly electricity generation and process heat. The challenge is that a higher price today may not pay off immediately. Rather, a clear, strong signal is needed for the planning and investments that will deliver emissions reductions in the coming years, so the country can enjoy the economic and well-being benefits of a low emissions economy.

Not least of these is reduced reliance on fossil fuels, which is a major contributor to the consumer price inflation driving current cost of living concerns. Less dependence on fossil energy sources reduces costs to households, increases energy security and offers real health benefits along with reducing greenhouse gas emissions. This is the logic behind the United States' Inflation Reduction Act, shifting one of the world's major emitters from laggard to leader in global climate action.

Enabling the NZ ETS to play its role in reducing emissions will give Aotearoa New Zealand a much better chance of meeting our emissions reductions targets and New Zealanders will be better placed to take advantage of the opportunities that come with acting on climate change.

If you would like to discuss any aspect of the Commission's advice on the NZ ETS settings, the Commissioners and Commission staff are more than willing to make ourselves available.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Rod Carr', written in a cursive style.

Dr Rod Carr
Chair of He Pou A Rangi Climate Change Commission