

# Advice on NZETS unit limits and price control settings for 2025- 2029

## Technical Annex 2: Assessment of accordance

February 2024



## Introduction

This document is published by He Pou a Rangi Climate Change Commission as a supplementary document to our *Advice on NZ ETS unit limit and price control settings for 2025–2029* (the advice report).

He Pou a Rangi Climate Change Commission is an independent Crown entity established by the Climate Change Response Act 2002 to provide expert, evidence-based advice and monitoring to successive governments on how to reduce emissions and adapt to the effects of climate change.

As part of our responsibilities under the Act, the Commission is required to provide the Government with annual advice on the unit limits and price control settings for the New Zealand Emissions Trading Scheme (NZ ETS) across a five-year window.

### About this document

This 'Assessment of accordance' sets out how we have considered the requirements of section 30GC of the Act: that recommended NZ ETS settings are in accordance with emissions budgets, the nationally determined contribution (NDC), and the 2050 target.

This document should be read alongside the Commission's advice on NZ ETS settings for 2025–2029. The advice report includes a summary in Appendix A, which sets out where legislative requirements and considerations under the Act were addressed in the Commission's advice; that provides a broader view than this document's focus on how the recommended settings accord with emissions reduction targets.

## Aligning NZ ETS settings with emissions reduction targets

The Commission is required to consider all relevant and mandatory matters in performing its functions and duties and exercising its powers under the Act.

In relation to our advice on NZ ETS settings, the key provisions of the Act are sections 5ZOA (obligations on the Commission), 30GB and 30GC (both obligations on the Minister but highly relevant to the Commission's obligations). The obligations under sections 30GC of the Act are set out in Box 1 below.

### **Box 1. The Act's requirement that NZ ETS settings accord with emissions reduction targets**

Under section 30GC of the Act sets out the requirements for regulations about limits and price control settings for units. Section 30GC(1) – (3) outlines a requirement that the NZ ETS settings accord with emissions reduction targets, as follows:

- (1) The Minister must comply with this section in—
  - (a) recommending under section 30GB(2), (3), or (4)(b) the making of regulations that prescribe individual limits, overall limits, or price control settings; and
  - (b) considering under section 30GB(4)(a) whether to recommend prescribing new individual limits, overall limits, and price control settings for the 2 calendar years before a further calendar year.
- (2) The Minister must be satisfied that the limits and price control settings are in accordance with—
  - (a) the emissions budget, and the nationally determined contribution for New Zealand under the Paris Agreement, that applies to—
    - (i) the period for which the limits or price control settings are being prescribed; or
    - (ii) any period after that, if a budget or contribution exists for that period; and
  - (b) the 2050 target.
- (3) However, they need not strictly accord with the budgets or contributions as long as the Minister is satisfied that the discrepancy is justified, after considering the other matters under this section.

## Context for this assessment

Our assessment (table 1 below) is provided at a point in time. The context of our advice is discussed in full in the advice report. In summary:

- Government decisions about its goals for emissions reductions and carbon dioxide removals, the role of the NZ ETS in achieving those goals, and a plan to meet the NDC are critical to address in its second emissions reduction plan. See Part 2: Current state and role of the NZ ETS of the advice report.
- Our method for calculating unit limits follows an adaptive management approach, that recognises settings can be regularly reviewed and if needed updated based on new

information, consistent with the system under the Act – see section Parts 1 and 3 of the advice report.

- The NZ ETS unit limits and price control settings must be considered as a package aligned to emissions reduction targets. These recommended settings are based on the probability of achieving the NZ ETS sectors' share of the targets, rather than precise mathematics. See Part 1: Introduction of the advice report.
- The Commission will give advice on emissions budgets and the 2050 target review later in 2024. The NZ ETS settings advice is based on the gazetted emissions budgets one, two and three and the 2050 target as legislated at the time this advice was prepared, in late 2023.

This wider context is helpful in reading the table below, containing the Commission's assessment of how its recommended NZ ETS settings accord with emissions budgets, the NDC and the 2050 target.

## Assessment table

Table 1: Assessment of accordance of the Commission’s recommended settings with emissions reduction targets as per section 30GC

Emissions reduction targets	Analysis and reasons for how our recommended unit limit and price control settings (2025-2029) accord with emissions reduction targets	Conclusion and justification for any discrepancies from strict accordance
Emissions budget 1 (2022-2025)	<p>The surplus of units in the NZ ETS (discussed in Part 3 Unit limits: Step 1 in the advice report) poses a risk of allowing emissions from NZ ETS sectors that exceed emissions budget 1. To mitigate this risk, our recommended settings reduce the auction volumes from 2025.</p> <p>We do not propose unit limit settings that eliminate the surplus by the end of the first emissions budget, as this is not practically feasible given the scale of the surplus and because the settings only cover one remaining year (2025) of the first emissions budget period.</p> <p>In practice there is a low risk of emissions exceeding the level of the first emissions budget, despite the recommended settings allowing a large surplus of units to persist over the period, because:</p> <ul style="list-style-type: none"> <li>• The proposed reductions to auction volume in 2025 as well as the downward adjustment to the NZ ETS emissions cap to reflect the 2023 Inventory methodological improvements together reduce the risk that the surplus poses to meeting the first emissions budget.</li> <li>• Recent Government emissions projections and assessments<sup>1</sup> show emissions are on track<sup>2</sup> to meet first emissions budget.</li> </ul> <p>The recommended price control settings provide a corridor for NZU price pathways consistent with meeting emissions budgets. For information on the analysis underpinning the recommended price control settings, in addition to the 2024 advice, see the Commission’s 2022 NZ ETS settings advice.<sup>3</sup> Together with the recommended unit limits, the price control settings support accordance with the first emissions budget because:</p>	<p>The settings are in accordance with the first emissions budget and provide a good probability that the first emissions budget will be met.</p> <p>A divergence from strict accordance due to the presence of a large number of surplus units in the scheme is justified, after considering the proper functioning of the scheme under section 30GC(5)(b). Eliminating the surplus within the one remaining year of the first emissions budget period covered by these settings is not feasible. Instead, the recommended unit limits for 2025 reduce the volume of units</p>

<sup>1</sup> MfE. 2023.

<sup>2</sup> Section 30GC(5)(b)

<sup>3</sup> He Pou a Rangi Climate Change Commission (2022a)

Emissions reduction targets	Analysis and reasons for how our recommended unit limit and price control settings (2025-2029) accord with emissions reduction targets	Conclusion and justification for any discrepancies from strict accordance
	<ul style="list-style-type: none"> <li>The cost containment reserve (CCR) trigger price levels are sufficiently high that there is a very low risk of it being triggered. If the CCR were triggered, it would release more units to the market which would be detrimental to accordance with the first emissions budget.</li> <li>The auction reserve price (ARP) level will also help discourage NZU prices from dropping to levels below which the first emissions budget is unlikely to be met. Note that the ARP is a soft price floor that only applies at auctions, so while it can help act as a brake on prices dropping, it cannot guarantee any NZU price outcome.</li> </ul>	<p>that the Government can auction in that year, based on an approach that aims to reduce the surplus to zero by 2030.</p>
Emissions budget 2 (2026-2030)	<p>The Commission’s recommended unit limit settings restrict auction volumes in a way designed to cause NZ ETS participants to use up the full amount of the Commission’s central surplus estimate (68 million units) by the end of the second emissions budget period (2030). If this surplus is successfully eliminated, the NZ ETS will be unable to allow emissions above the second emissions budget level.</p> <p>However, the size of the surplus is inherently uncertain (see <i>Part 3 Unit limits: Adaptive management</i> in the NZ ETS settings advice). There is still some risk that these settings could result in surplus units allowing emissions above the level of the second emissions budget, but it cannot be quantified or judged as a discrepancy from strict accordance at this time.</p> <p>This risk is mitigated to an extent by the Commission basing its recommended unit limit settings on an NZ ETS emissions cap that has been adjusted downwards to reflect methodological improvements to the Inventory. The emissions allocation to NZ ETS sectors under these settings is approximately 4 Mt lower across 2026-2030 than the emissions allocation would be if the settings were aligned to up to the maximum share available to NZ ETS sectors of the gazetted second emissions budget (the NZ ETS sectors share is net emissions of 94.6Mt out of a total 305Mt budget)).</p> <p>The price control settings support accordance with the second emissions budget in the same way as noted above on the first emissions budget.</p>	<p>The settings strictly accord with the second emissions budget.</p> <p>The combination of reduced unit limit settings, reflecting a reduced NZ ETS emissions cap and increased surplus drawdown, together with the price control settings giving a very high probability that emissions from NZ ETS sectors will not exceed those sectors’ share of the second emissions budget volume.</p>

Emissions reduction targets	Analysis and reasons for how our recommended unit limit and price control settings (2025-2029) accord with emissions reduction targets	Conclusion and justification for any discrepancies from strict accordance
	<p>We also considered the implications for the CCR of the latest government emissions projections, which show an expected downward trend in emissions due to, among other things, investments in electrification of steel manufacturing (see Box 2, page 42 of the advice report). This expected reduction in demand for units means that we judge – all other things held equal – that the market is likely to follow a lower price path compared to the scenarios considered when the current price control settings were first recommended in 2022. Under the Commission’s recommended settings there would be an even lower likelihood that the CCR will be triggered than anticipated previously, as the NZ ETS emissions cap has not been reduced in response to this expected reduction in demand.</p>	
Emissions budget 3 (2031-2035)	<p>The Commission’s recommended unit limit settings over 2025-2029 are designed to eliminate the surplus units from the scheme by 2030, i.e. to fully mitigate the risk that surplus units could enable emissions above the third emissions budget which starts in 2031.</p> <p>In addition, the Commission’s current NZ ETS unit limits methodology includes an adjustment downward to reflect methodological improvements from the latest GHG Inventory. If this methodology is used to project the unit limits out to the end of the third emissions budget period (2035), it puts them on a trajectory that sits below the NZ ETS sectors’ share of the third emissions budget by 4 Mt cumulatively over 2031-2035 (the NZ ETS sectors share is net emissions of 38Mt out of a total 240Mt budget)).</p> <p>We have identified two risks to strict accordance with the third emissions budget, associated with uncertainties connected with the design of the NZ ETS and with how the future will play out. If in future these risks become realities, the rolling five-year process for updating the NZ ETS settings regulations enables an adaptive management approach to manage their impact, as they can be adjusted each year as more information becomes available.</p> <p>Specifically, the risks we have identified and options available to address them, if they eventuate, are:</p> <ol style="list-style-type: none"> <li>1. <i>Risk due to uncertainty in the estimate of surplus units.</i> The recommended unit limit settings have been designed based on the Commission’s central estimate of the surplus (68 million units). It is possible that the surplus is closer to the higher end of the Commission’s estimated range (84 million units), or that it could</li> </ol>	<p>The settings strictly accord with the third emissions budget.</p> <p>The settings are designed to draw down all the surplus units, as best as they can be estimated at this time, by 2030. These settings therefore are in strict accordance with the third emissions budget as no surplus units will remain from 2031 that could enable emissions above the budget level.</p> <p>We have considered two specific risks that, if they eventuate, could mean that in future the settings may no longer be in strict accordance with emissions</p>

Emissions reduction targets	Analysis and reasons for how our recommended unit limit and price control settings (2025-2029) accord with emissions reduction targets	Conclusion and justification for any discrepancies from strict accordance
	<p>grow in future (see <i>Part 3: Step 5 set the surplus reduction volume</i> of the advice report for more information). If this is the case, under the recommended unit limit settings some surplus units could still be present in the NZ ETS after 2030.</p> <p>This risk could be managed by further downward adjustments to the unit limits that reduce the units the government can auction into the scheme. This could occur within the second emissions budget period, if the information for updated surplus estimates is available in time for the 2025 or 2026 regulations updates. This risk is part of the reason why the Commission has recommended that the settings be amended from 2025 rather than from 2027. Reducing auction volumes earlier preserves higher auction volumes over 2027-2030, enabling further downward adjustments to unit limits in those years if necessary.</p> <p>Aiming to draw the surplus down entirely by 2030 also means that there is also some scope to reduce the unit limits applying after 2030, even though the NZ ETS emissions cap declines over time. The way the unit limit settings recommended this year frontload surplus reductions over 2025-2030 preserves more auction volume after 2030.</p> <p>2. <i>Risks from industrial allocation volumes.</i> The forecast of industrial allocation used to develop the Commission’s unit limit recommendations is based on current policy as of late 2023 and is uncertain. If the Commission’s methodology is used to project unit limits forward to 2035, this forecast results in industrial allocation exceeding the NZ ETS emissions cap in 2035 by 0.8Mt (although the emissions cap sits below the level of the third emissions budget, see paragraph above).</p> <p>It is likely, however, that the forecast is an overestimate. The baselines used to determine the amount of industrial allocation the government gives out are due to be updated in 2024, which is expected to reduce</p>	<p>budget 3, but conclude that the recommended settings allow for them to be managed (discussed in adjacent column).</p> <p>Overall, by setting a trajectory for settings in the emissions budget 2 period, there is a strong case that the settings give a very high probability of keeping NZ ETS sector emissions on track to stay within the level allowed by the third emissions budget.</p>



Emissions reduction targets	Analysis and reasons for how our recommended unit limit and price control settings (2025-2029) accord with emissions reduction targets	Conclusion and justification for any discrepancies from strict accordance
	<p>industrial allocation significantly.<sup>4</sup> This change can be considered in future updates to the NZ ETS settings regulations, and whether industrial allocation volume is likely to exceed the NZ ETS emissions cap in the 2030s can be monitored. If the issue still appears likely in 2026 when the NZ ETS settings first extend into the third emissions budget period (as they will cover 2027-2031), it could be addressed by reducing auction volume in 2031. The potential 0.8Mt excess industrial allocation volume is of a scale that could be adjusted for in 2031 via existing levers.</p> <p>The price control settings support accordance in the same way as noted above against the first and second emissions budgets.</p>	
Nationally determined contribution for 2021-2030	<p>New Zealand will manage its first NDC using a multi-year emissions budget. The Commission has calculated an updated provisional NDC budget of 561Mt CO<sub>2</sub>e, taking into account methodological updates to the latest 2023 national GHG Inventory.<sup>5</sup></p> <p>The first NDC is a considerably stricter emissions limit than New Zealand’s targeted domestic emissions levels over 2021-2030<sup>6</sup>, which together total 668Mt CO<sub>2</sub>e. The abatement gap between this and the first NDC budget is therefore estimated at 107Mt CO<sub>2</sub>e, up 8Mt CO<sub>2</sub>e from the 99Mt CO<sub>2</sub>e as per the provisional estimates prepared</p>	The recommended NZ ETS settings do not strictly accord with the NDC, and a discrepancy is justified. The recommended settings accord with emissions budgets as the domestic contribution to meeting the NDC.

<sup>4</sup> We have not been able to take this into account in the recommended settings because as of December 2023 as the regulations setting out allocative baselines for eligible industrial activities have not yet been updated, meaning the as the scale of the reduction in industrial allocation volumes is still too uncertain to incorporate.

<sup>5</sup> The Commission’s updated estimate was calculated consistent with the methodology the government used to calculate the previous provisional NDC budget estimate. There is, however, some ambiguity about how the NDC budget is to be updated for new data since the NDC commits to a 50% reduction from actual 2020 net emissions, and also to a 41% reduction from the level of the 2020 target (5% below 1990 levels). When the NDC was set these approaches resulted in the same budget level, but with revised emissions data the results differ slightly.

<sup>6</sup> The targeted domestic emissions level includes 2021 emissions (72.8Mt CO<sub>2</sub>e) plus first emissions budget (290Mt CO<sub>2</sub>e) and second emissions budget (305Mt CO<sub>2</sub>e) levels.

Emissions reduction targets	Analysis and reasons for how our recommended unit limit and price control settings (2025-2029) accord with emissions reduction targets	Conclusion and justification for any discrepancies from strict accordance
	<p>using the previous Inventory. Both the Commission and the government have assessed<sup>7</sup> that in addition to domestic emissions reductions, New Zealand will need to use offshore mitigation to help meet the NDC.</p> <p>As in previous NZ ETS settings advice, the Commission considered strictly according the NZ ETS settings with the NDC. This would involve significantly reduced unit limits as well as increased cost containment reserve price triggers, to enable the corresponding domestic emissions reductions. The Commission has not recommended settings based on this approach, because:</p> <ul style="list-style-type: none"> <li>• It would mean aiming to meet the NDC entirely domestically. At present, the NZ ETS is domestic-only with no overseas units approved for use in the scheme, and the Government has not announced that it has agreed any instruments or contracts with other jurisdictions to access emissions reductions in their carbon markets (s30GC(5)(c)).</li> <li>• Information about the forecast availability and cost of ways to reduce greenhouse gas emissions (s30GC(5)(d)) at the scale needed and over the short time available to meet the NDC domestically by 2030 shows that this would be highly likely to lead to severe social and economic impacts on households and the economy (s30GC(6)(a)).<sup>8</sup> Due to their magnitude, these impacts would be difficult to compensate for using levers in the tax and welfare system.</li> </ul> <p>We recommend NZ ETS settings that accord with the NDC by aligning the unit limits and price control settings with emissions budgets as the intended domestic contribution to meeting the NDC. This reflects that the government can obtain offshore mitigation using avenues other than the NZ ETS, for example by directly purchasing the offshore mitigation itself. Work appears to be underway by government ministries to secure access to the offshore mitigation needed to meet the NDC. Various government statements and documents signal the Government’s intentions to</p>	<p>The discrepancy from strict accordance with the NDC is justified having considered sections 30GC(5)(c), 30GC(5)(d) and 30GC(6)(a) (discussed in adjacent column).</p>

<sup>7</sup> He Pou a Rangi Climate Change Commission (2021) and Te Tai Ōhanga The Treasury and Ministry for the Environment (2023).

<sup>8</sup> He Pou a Rangi Climate Change Commission. (2022a)

Emissions reduction targets	Analysis and reasons for how our recommended unit limit and price control settings (2025-2029) accord with emissions reduction targets	Conclusion and justification for any discrepancies from strict accordance
	<p>acquire offshore mitigation; over the past year this has included Cabinet’s consideration in July 2023 of an NDC strategy and agreement to further work on how to meet the NDC.<sup>9</sup> As noted in our 2024 NZ ETS settings advice, while we consider this the appropriate approach to managing the NZ ETS settings now, the Government will need to make progress on obtaining offshore mitigation and a credible plan for meeting the NDC for it to remain viable in the future.</p> <p>Finally, compared to the status quo NZ ETS settings in regulations, our recommended unit limit settings have been adjusted downwards to reflect methodological improvements in the 2023 national Inventory (see <i>Part 3: Step 1 Align with emissions reduction targets</i> in the 2024 NZ ETS settings advice). The unit limits settings are around 6 million units lower over the period 2021 to 2030 than they otherwise would be because of this approach (which represents the NZ ETS sectors’ share of the 8Mt CO<sub>2</sub>e increase to the abatement gap referred to in the second paragraph above).</p>	
2050 target	<p>The recommended settings are in accordance with the first emissions budget and in strict accordance with the second and third emissions budgets as set out above. As emissions budgets act as the stepping-stones towards achieving the 2050 target, this puts NZ ETS sectors on the path to make their contribution to meeting the 2050 target.<sup>10</sup> We have based this assessment on the effect the recommended NZ ETS settings regulations can have on emissions from NZ ETS sectors over the period of the regulations (2025-2029) and on the units likely to be available in the scheme out to 2035.</p> <p>Due to the current structure of the NZ ETS, it will have very little ability to drive further gross or net emissions reductions to achieve the 2050 target beyond the mid-2030s, as the NZ ETS emissions cap will reach zero in 2037</p>	<p>The recommended settings strictly accord with the 2050 target through according with the first emissions budget and strictly according with the emissions budgets 2 and 3.</p> <p>The recommended settings will reduce the units available to</p>

<sup>9</sup> Ministry for the Environment (2023b).

<sup>10</sup> As currently legislated the NZ ETS does not cover all of New Zealand’s greenhouse gas emissions with surrender obligations, most notably agricultural methane and nitrous oxide are not covered.

Emissions reduction targets	Analysis and reasons for how our recommended unit limit and price control settings (2025-2029) accord with emissions reduction targets	Conclusion and justification for any discrepancies from strict accordance
	<p>under current policy and legislative settings. This point is discussed in the Commission’s advice to the Government on its second emissions reduction plan.<sup>11</sup> This means that the Government will either need to amend the overall structure of the NZ ETS, or implement other policies, to keep driving emissions from NZ ETS sectors down to meet the 2050 target.</p> <p>This is not an issue that can be addressed or corrected for by amending the NZ ETS unit limit and price control settings; therefore, we do not consider that this future policy gap undermines the recommended settings’ accordance with the 2050 target.</p>	<p>give a high probability that NZ ETS sectors’ emissions follow a pathway consistent with meeting all three emissions budgets; so, the settings will also put these emissions on a pathway consistent with NZ ETS sectors making their contribution to meeting the 2050 target.</p>

---

<sup>11</sup> He Pou a Rangi Climate Change Commission (2023a)

## References

- He Pou a Rangi Climate Change Commission. (2021). *Ināia tonu nei: a low emissions future for Aotearoa* <https://www.climatecommission.govt.nz/public/Inaia-tonu-nei-a-low-emissions-future-for-Aotearoa/Inaia-tonu-nei-a-low-emissions-future-for-Aotearoa.pdf>>
- He Pou a Rangi Climate Change Commission. (2022a) Advice on NZ ETS unit limits and price control settings for 2023-2027. <https://www.climatecommission.govt.nz/public/ETS-advice-July-22/PDFs/NZ-ETS-settings-2023-2027-final-report-web-27-July-2022.pdf>
- He Pou a Rangi Climate Change Commission. (2023a). 2023 Advice on the direction of policy for the Government's second emissions reduction plan. <https://climatecommission.govt.nz/public/Advice-to-govt-docs/ERP2/final-erp2/ERP2-Final-Advice-for-web.pdf>
- Ministry for the Environment. (2023b). Nationally Determined Contribution Strategy <https://environment.govt.nz/what-government-is-doing/cabinet-papers-and-regulatory-impact-statements/nationally-determined-contribution-strategy>
- Ministry for the Environment. (2023). New Zealand's historical and projected greenhouse gas emissions from 1990 to 2050. <https://environment.govt.nz/facts-and-science/climate-change/new-zealands-projected-greenhouse-gas-emissions-to-2050/>
- Ministry for the Environment. (2023c). Planned methodological improvements for Aotearoa New Zealand's Greenhouse Gas Inventory 1990-2021. <https://environment.govt.nz/assets/publications/Planned-methodological-improvements-GHG-Inventory-19902021.pdf>
- Te Tai Ōhanga The Treasury and Ministry for the Environment. (2023). Ngā Kōrero Āhuarangi Me Te Ōhanga: Climate Economic and Fiscal Assessment 2023 (Wellington: Te Tai Ōhanga The Treasury) <https://www.treasury.govt.nz/sites/default/files/2023-04/cefa23.pdf>

**He Pou a Rangi  
Climate Change Commission**

Level 21, 1 Willis Street  
Wellington 6011  
PO Box 24448  
Wellington 6142

[www.climatecommission.govt.nz](http://www.climatecommission.govt.nz)

**Te Kāwanatanga o Aotearoa**  
New Zealand Government