

## **In-Confidence**

**Office of the Minister of Energy and Resources**

**Office of the Minister for the Environment**

**Office of the Minister of Forestry**

**Office of the Minister of Climate Change**

**Cabinet Environment Committee**

## **Consultation on a review of the New Zealand Emissions Trading Scheme to incentivise emission reductions**

### **Proposal**

- 1 This paper seeks agreement to release a discussion document on options to support a review of the New Zealand Emissions Trading Scheme (NZ ETS) (Appendix A) for public consultation.
- 2 The discussion document seeks feedback on whether to amend the NZ ETS to prioritise gross emissions reductions, and on options to prioritise gross emissions reductions in the NZ ETS, while continuing to support removals.

### **Relation to Government priorities**

- 3 The Government declared a climate change emergency on 2 December 2020. The Cabinet Business Committee (CBC) agreed that climate change “demands a sufficiently ambitious, urgent, and coordinated response across government to meet the scale and complexity of the challenge” [CBC-20-MIN-0097 refers].
- 4 Enabling a just transition to a low-emissions, climate resilient future is a Government priority. CBC declared its intention to “put the climate at the centre of government decision-making” [CBC-20-MIN-0097 refers].
- 5 The proposals in this paper relate to the Cooperation Agreement between the Labour and Green Parties. Achieving the purpose and goals of the 2019 zero carbon amendments to the Climate Change Response Act 2002 is an agreed area of cooperation.
- 6 Aotearoa New Zealand’s first emissions reduction plan was published in May 2022. As part of this plan, the Government publicly committed to undertake a review of further policy analysis on unit supply in the NZ ETS to assess whether additional changes are needed to the NZ ETS to balance gross and net emissions reductions (Action 5.2.1).

## Executive summary

- 7 The NZ ETS is the government's main emissions pricing tool and is a vital component of Aotearoa New Zealand's climate change response. The NZ ETS needs to make a significant contribution to meeting our domestic emissions budgets, 2050 targets, and 2030 Nationally Determined Contribution (NDC) under the Paris Agreement.
- 8 In May 2021, the Climate Change Commission (the Commission) issued its report *Inaia Tonu Nei: A low-emissions future for Aotearoa* and, based on its demonstration pathway to meet the 2050 net zero target, recommended the Government amend the NZ ETS to strengthen the incentives for gross emissions reductions and manage the amount of exotic forest planting the scheme drives (recommendations 11.1 and 25.2a).
- 9 More recent draft advice from the Commission for the second emissions reduction plan has reiterated these recommendations. It has recommended making the emissions pricing system consistent with specific levels of gross emissions reductions for the second and third emissions budgets. This includes separating the incentives within the NZ ETS for gross emission reductions from those applying to forestry (proposed recommendation 3). The Commission is currently consulting on its draft advice, with consultation ending on 20 June 2023.
- 10 In December 2021, Cabinet agreed to prioritise gross emissions reductions in the emissions reduction plan, while maintaining support for net emission reductions, in line with the Commission's analysis and advice on emissions budgets [DEV-21-MIN-0277 refers]. This was followed by a Cabinet decision in May 2022 to review the NZ ETS to consider whether changes are needed to better support this objective [CAB-22-MIN-0152 refers]. These decisions were announced as part of the emissions reduction plan
- 11 Reducing our gross emissions is critical to our transition to a low-emissions economy. Evidence shows that the current design and settings of the NZ ETS are expected to drive significant exotic afforestation between 2022 and 2035, but only limited gross emissions reductions and native afforestation. The discussion document seeks feedback on the role of the NZ ETS price in driving gross emissions reductions.
- 12 The discussion document details four high-level options that have been identified as part of the NZ ETS review. These options represent different ways to incentivise gross emissions reductions in the NZ ETS. Each option reflects different degrees of change from the existing system.
- 13 The options outlined in the discussion document also seek to support removals. While the NZ ETS may need to drive steeper cuts in our gross emissions, we need significant new forestry in the coming years to achieve our climate goals and realise the additional benefits that forestry can provide.
- 14 We propose to consult on the proposals to redesign the permanent forest category in the NZ ETS, alongside this consultation on the NZ ETS review.

Both consultations will affect similar stakeholders, and the Government will need to make cohesive decisions across both programmes.

- 15 Alongside this review, a number of other work programmes that recognise the vital importance of forestry and other removals are being progressed. These include exploring a voluntary carbon market and a biodiversity credit system for removals, and broader work on carbon removals.
- 16 We seek Cabinet agreement to consult on the appended discussion document on the NZ ETS review. We propose that consultation takes place over an eight-week period between 19 June and 11 August 2023.
- 17 We intend to return to Cabinet when appropriate to report back on the outcome of the consultation and advise on the next steps of the review. No legislative or regulatory changes will be pursued before the election. Any changes to the NZ ETS consulted on in this discussion document would be subject to further public consultation on the detailed design of proposal next term.

## **Background**

*Aotearoa New Zealand is committed to taking meaningful action on climate change and contributing to global efforts to limit temperature rise to 1.5 degrees*

- 18 In May 2022, the first three emissions budgets were gazetted (2022-25, 2026-30, 2031-35) and the first emissions reduction plan was published. These are significant steps in Aotearoa New Zealand's transition and represent the Government's commitment to reduce emissions across the economy to meet our domestic climate change goals (including the 2050 target<sup>1</sup>) and contribute to global efforts to limit temperature rise to 1.5 degrees above pre-industrial levels.
- 19 Aotearoa New Zealand has also set its first Nationally Determined Contribution under the Paris Agreement (NDC1). This sets a headline target of a 50 per cent reduction of net emissions below our gross 2005 level by 2030.

*The NZ ETS needs to play a key role in helping Aotearoa New Zealand meet its climate change goals*

- 20 Emissions pricing is a fundamental component of our emissions reduction strategy. The NZ ETS is an economy-wide tool that enables businesses, households, and the public sector to incorporate the costs of emissions and the benefits of reducing or removing emissions into day-to-day decisions.
- 21 As the government's main emissions pricing tool, the NZ ETS needs to make a significant contribution to meeting our emissions budgets and 2050 target.

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<sup>1</sup> The 2050 target is enshrined in the Climate Change Response Act 2002 and requires all greenhouse gas emissions (except biogenic methane) to reach net zero by 2050. It also requires biogenic methane emissions to reduce to 24-47 per cent below 2017 levels by 2050, including a 10 per cent reduction by 2030.

- 22 The NZ ETS will also contribute to delivering our NDC1 during the period of 2021-2030, with Cabinet agreeing that Aotearoa New Zealand's domestic climate action will be prioritised and complemented with offshore mitigation strategies [CAB-21-MIN-0435].

*The Climate Change Commission recommends amending the NZ ETS to strengthen incentive for gross emissions reductions and to manage the amount of exotic forest driven by the NZ ETS*

- 23 In May 2021, the Climate Change Commission (the Commission) released its report *Inaia Tonu Nei: A low-emissions future for Aotearoa*, in which it recommended, based on its demonstration pathway to meet the 2050 net zero target, the Government amend the NZ ETS to strengthen the incentives for gross emissions reductions and manage the amount of exotic forestry driven by the scheme (recommendations 11.1 and 25.2a). The Commission repeated these recommendations in its advice on NZ ETS unit and price control settings in 2022 and 2023.
- 24 In April 2023, the Commission released its draft advice for the second emissions reduction plan. The Commission proposed amending the NZ ETS to deliver specific levels of gross emissions for the second and third emissions budgets. This includes separating the incentives for gross emission reductions from those for forestry within the NZ ETS (proposed recommendation 3). The Commission is currently consulting on its draft advice.

*Current NZ ETS settings are not expected to deliver the emissions reductions needed to decarbonise the economy and achieve our climate change goals*

- 25 In December 2021, Cabinet agreed to prioritise gross emissions reductions in the emissions reduction plan, alongside maintaining support for net emissions reductions [CAB-21-MIN-0547.02].
- 26 Prioritising gross emissions reductions could mean incentivising the uptake of low-emissions technology, energy efficiency measures, and other abatement opportunities as quickly as real-world constraints allow. Maintaining support for net emissions reductions would mean driving levels of removals sufficient to help meet our climate change goals in the short-to-medium term and to provide a sink for hard-to-abate emissions in the longer term.
- 27 The current design of the NZ ETS is not expected to incentivise meaningful gross emissions reductions in sectors such as energy, industry, transport, and waste. As a result, the NZ ETS does not align with:
- 27.1 the Government's emphasis on gross emissions reductions in the emissions reduction plan
  - 27.2 the Commission's modelling, which suggested that sustained increases in Aotearoa New Zealand's carbon prices would be needed to reduce our gross emissions and meet the 2050 target
  - 27.3 the Commission's recommendations 11.1 and 25.2a.

### *Cabinet has agreed to a review of the NZ ETS*

- 28 In May 2022, Cabinet agreed in principle to the Commission's recommendations, subject to the outcomes of a targeted review of the NZ ETS [CAB-22-MIN-0152]. This was announced as part of the launch of the Emissions Reduction Plan that month.
- 29 Cabinet confirmed the scope of this review in September 2022. It agreed that the review would focus on whether, and if so how, to strengthen the incentives for gross emissions reductions in the NZ ETS and manage the amount of exotic forestry driven by the scheme [CAB-22-MIN-0412]. The Cabinet-mandated questions that were raised as part of the review are reiterated in the relevant sections below.

### *Ministerial Inquiry into Land Use in Tairāwhiti and Wairoa*

- 30 On 23 February 2023, the Ministerial Inquiry into Land Use in Tairāwhiti and Wairoa (the Inquiry) was announced, sponsored by the Environment and Forestry Ministers. The purpose of the Inquiry was to describe the history of land uses associated with the mobilisation of woody debris (including forestry slash) and sediment in the Tairāwhiti and Wairoa Districts, and to make recommendations about the further work needed to address impacts of land use and storms.
- 31 The Inquiry's findings and recommendations were released on 12 May 2023. Recommendations include requiring land with an extreme erosion susceptibility to be transitioned to permanent canopy cover and changes to the way production forests are harvested, as well as expanding the NZ ETS review to include other considerations.
- 32 The government is considering its response to the Inquiry's recommendations, some of which are directly relevant for the NZ ETS review and the redesign of the permanent forest category.

### **Analysis**

*The discussion document seeks public feedback on whether and how to amend the NZ ETS to strengthen incentives for gross emissions reductions*

- 33 We seek approval to release the appended discussion document for public consultation between 19 June and 11 August 2023.
- 34 The discussion document seeks feedback to inform the analysis for the NZ ETS review and specifically details:

- 34.1 Expectations for future trajectories of gross emissions reductions and removals under the current NZ ETS design and settings (problem definition)
- 34.2 Whether to prioritise gross emissions reductions in the NZ ETS and what incentives are wanted for emissions removals (objective)
- 34.3 Broader outcomes that the NZ ETS should support
- 34.4 Options to prioritise gross emissions reductions in the NZ ETS, while still supporting removals.

*Existing NZ ETS settings are expected to drive significant exotic afforestation but limited gross emissions reductions*

- 35 Cabinet agreed the review should consider the balance of gross and net emissions that the current design and settings of the NZ ETS are expected to drive, as well as the economic, environmental, and distributional impacts of this balance [CAB-22-MIN-0412].
- 36 The NZ ETS applies a single price to emissions and removals, which drives investment in the lowest-cost source of abatement first. More costly abatement is incentivised over time as the carbon price increases.
- 37 Within the current NZ ETS, there are few levers to influence the type of abatement that it drives. This means the government cannot drive specific volumes or types of reductions or removals through pricing. There are no ways to manage the amount of emissions units (New Zealand Units or NZUs) that can be earned for carbon sequestration in forests or distinguish between NZUs provided for indigenous tree growth or exotic tree growth.
- 38 This design is expected to drive large-scale exotic afforestation towards net emissions reductions. Exotic forests are currently one of the lowest-cost and scalable sources of abatement in Aotearoa New Zealand.
- 39 Under current settings, low levels of native afforestation are also likely over the same period because native forests earn NZUs more slowly than some exotic forests and have higher establishment costs.
- 40 Without changes, the NZ ETS is expected to play a limited role in reducing gross emissions and decarbonising Aotearoa New Zealand's economy. This is because the costs of reducing emissions tends to be higher than the cost of removals through exotic forestry. Gross emissions reductions can also be less responsive to carbon pricing, be capital intensive, and require specialised investments. Therefore, we are more likely to get removals than gross emissions reductions.
- 41 In addition to the current design not driving material reduction in gross emissions, agencies' modelling suggests the total supply of NZUs could exceed the demand from NZ ETS participants with surrender obligations, if foresters expect the NZU price to remain at current levels. This development could lead to an NZU stockpile that is continuously increasing, up to

unsustainably high levels. The NZ ETS market would most likely respond to this with a falling NZU price, as shown below in Figure 1 and Figure 2.

- 42 The forecast supply and demand dynamics in the NZ ETS could undermine the scheme's ability to properly function and maintain a strong and stable emissions price. This would weaken NZ ETS incentives for both gross emissions reductions and removals.
- 43 Falling NZ ETS prices could negatively affect the forestry sector, and Aotearoa New Zealand's net emissions, by undermining current and future forestry investments and creating perverse incentives for deforestation. This could increase net emissions in the future.

*The review is considering what changes could be made to the NZ ETS to incentivise gross emissions reductions while supporting removals*

- 44 Cabinet agreed that the NZ ETS review should consider [CAB-22-MIN-0412]:
  - 44.1 the balance of gross and net emissions reductions the NZ ETS should incentivise in the future and how this balance should change over time
  - 44.2 the current role that NZ ETS plays in meeting Aotearoa New Zealand's NDCs, as well as the role that it should play in the future
  - 44.3 the level of net emissions reductions that should be from exotic forests and indigenous forests, as well as how to improve NZ ETS incentives for indigenous afforestation.

*Forestry and other removals are critical to achieving our climate change goals*

- 45 Forestry is needed to meet Aotearoa New Zealand's first three emissions budgets.<sup>2</sup> New forests<sup>3</sup> are projected to contribute 77 to 97 million tonnes of carbon dioxide removals over these three emissions budgets. Compared to other forms of abatement, forestry removals are low-cost and can be successfully scaled up and deployed.
- 46 Forestry also contributes to meeting Aotearoa New Zealand's NDCs. Due to the time lag between planting and forests absorbing significant amounts of carbon, greater afforestation now will not contribute significantly to Aotearoa New Zealand's NDC1. However, these removals would contribute to future NDCs, which must get progressively ambitious. By increasing the contribution of domestic removals, we could reduce the amount of offshore mitigation that may be needed for future NDCs.

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<sup>2</sup> Emissions budgets specify the net amount of greenhouse gas emissions that is permitted over a five-year period (or four years in the case of the first emissions budget). The first three emissions budgets were gazetted in May 2022. The first emissions budget (2022-2025) is set at 290 MtCO<sub>2</sub>e. The second emissions budget (2026-2030) is set at 305 MtCO<sub>2</sub>e. The third emissions budget (2031-2035) is set at 240 MtCO<sub>2</sub>e.

<sup>3</sup> Includes only afforestation planted between 2022 and 2035.

- 47 In addition, forestry could be used to establish long-term carbon sinks for hard-to-abate emissions. This would help Aotearoa New Zealand maintain net zero, or go net negative, after 2050.

*Material gross emissions reductions are required*

- 48 While forestry and other forms of removals are of critical importance, Aotearoa New Zealand will be in a strong position if we also act to reduce our gross emissions now. Taking these steps in tandem will give Aotearoa New Zealand the best chance of achieving climate targets at a lower cost and with greater benefits. The Commission argued that significant cost savings could be made in Aotearoa New Zealand's energy system from investing in reducing gross emissions now. It also found that delaying some investments that reduce gross emissions could result in higher economic costs over the long-term.
- 49 Further, reducing gross emissions is needed to lock in net zero beyond 2050. If our transition requires exotic afforestation on an ongoing basis, more and more rural land will be needed to remove emissions. This scale of land use change risks the social license for the forestry sector and reduces land use flexibility for future generations.
- 50 In addition, reducing gross emissions will help Aotearoa New Zealand stay in step with other countries that are rapidly decarbonising their economies. Other jurisdictions are focussing on reducing gross emissions. Without similar domestic reductions, Aotearoa New Zealand risks being seen as out-of-step with these countries. This could affect:
- 50.1 Aotearoa New Zealand's reputation, as well as access to markets and capital if overseas consumers and financial institutions increasingly demand specific climate standards for our products and services
  - 50.2 Aotearoa New Zealand's ability to link with overseas carbon markets if the NZ ETS is seen as being ineffective at driving gross reductions.
- 51 There is a risk that prioritising gross emission reductions in the NZ ETS could make Aotearoa New Zealand's transition more expensive in the short to medium term, particularly for firms exposed to high emission costs. These costs would also likely get passed onto households through fuel and electricity usage.
- 52 However, reducing gross emissions now could also lead to cost savings for households over the long run. Investments in renewable energy would be expected to reduce electricity prices in the future. Furthermore, higher fuel prices could be moderated over time by fuel switching and transport mode shifts driven by stronger NZ ETS incentives. These changes would help lower the costs of goods and services that currently include a substantial carbon component.
- 53 Through this consultation, we will test our initial assessment that on balance, prioritising gross emissions reductions within the NZ ETS while maintaining



support for removals is the preferred approach to our transition to a low-emissions economy.

*There is also an opportunity to consider whether the NZ ETS should support broader outcomes*

- 54 In September 2022, Cabinet agreed that the NZ ETS review should consider how to include additional sources of removals in the NZ ETS, and whether the NZ ETS should also support co-benefits, such as biodiversity [CAB-22-MIN-0412].
- 55 Expanding the NZ ETS could help incentivise a greater range of removal activities. The NZ ETS currently rewards only carbon removals from eligible forests and some industrial activities and does not reward other removal activities which may provide co-benefits. Recognising co-benefits in the NZ ETS could generate a wider range of positive outcomes.
- 56 However, directly rewarding co-benefits can make the NZ ETS less effective at incentivising carbon removals because rewarding co-benefits requires paying more for the same amount of carbon. There are potential mechanisms other than changing the NZ ETS that could be used to reward these co-benefits, such as developing a voluntary carbon market or a biodiversity credit system.

*The NZ ETS review has identified options to prioritise gross emissions reductions*

- 57 Cabinet agreed that the NZ ETS review should [CAB-22-MIN-0412]:
- 57.1 Consider how the NZ ETS could be amended to support the government's preferred balance of gross and net emissions reductions
- 57.2 Identify options for amending the design and settings of the NZ ETS and strengthen incentives for gross emissions reductions.
- 58 The NZ ETS review has identified four high-level options to incentivise gross emissions reductions in the NZ ETS, while also encouraging removals. Each option reflects an increasing degree of change from the status quo. In particular:
- Option 1: Use existing NZ ETS levers to strengthen incentives for net emissions reductions
  - Option 2: Create increased demand for removal activities to increase net emissions reductions
  - Option 3: Strengthen incentives for gross emissions reductions by changing the incentives for removals
  - Option 4: Create separate incentives for gross emissions reductions and emissions removals.

- 59 There are several potential policy levers or redesign choices which could be applied within each high-level option. These will vary in their ability to incentivise gross emissions reductions as well as in the degree of change they will have on the market.
- 60 All options would need additional design work following this round of public consultation. Decisions following consultation will be a matter for the next government. Feedback from submissions will enable officials to advise the incoming government on next steps for the review of the NZ ETS. Any changes to the NZ ETS would be subject to further public consultation on the detailed design of proposals. The effectiveness of the options in incentivising gross reductions will also be subject to non-price barriers being addressed.
- 61 Option 1 would be expected to result in an NZU price increase in the short term. This could incentivise gross reductions but also additional removal activities. The long-term effectiveness of this option is expected to be limited due to the expected increase in NZUs from forestry removals that will become available.
- 62 Option 2 could enable a more sustained increase in the price for emissions and removals, provided the government continues to take action to increase the demand for NZUs. This would be achieved by enabling international buyers or the government to purchase NZUs. However, it is unlikely international buyers would want to purchase units that still contribute to New Zealand's NDCs. Purchasing units on the secondary market could also come at a high price to the government. Therefore, there is uncertainty about how much future government will be willing to pay, and whether international buyers would want to purchase unadjusted units.
- 63 Option 3 would increase the incentive for emissions reductions by reducing the incentive for removals in the NZ ETS. This could help the government drive specific levels of reductions and removals. This option would likely reduce the incentive to undertake additional removal activities unless complementary policies are put in place.
- 64 Option 4 would create two separate NZ ETS markets with two separate prices – one for emissions reduction activities and another for removal activities. In addition to the current auction market, removal activities would be sold on a separate market – either directly to the government or with emitters through a new market mechanism. This option would allow the government to incentivise reductions and removals independently towards budgets and targets, and represents the most comprehensive change to the NZ ETS, relative to the other options.
- 65 Different policy options will impact different parts of the economy in different ways. Increases to NZU prices, and therefore higher costs for emissions, are likely to be passed onto consumers, especially in the transport and energy sectors. If costs become too high some businesses may be forced to close or transition. While this may have little impact at a national scale, it could significantly impact local economies and employment.

- 66 For Options 1 and 2, sectors involved in removal activities, such as forestry, would benefit from a high emissions price in the short-term. However, this may have flow-on effects, such as encouraging land-use conversion from pasture to forestry and impact some rural communities as employment and supporting industry requirements might change.
- 67 Options 3 and 4 would involve significant changes to how removals and reductions are treated in the NZ ETS. This could create uncertainty in investing in additional removals and would need to be carefully considered given the importance of forestry and other removals for meeting our NDCs.
- 68 The exclusion of removal activities from the NZ ETS without providing for an alternative mechanism to incentivise removals is not being considered as part of this consultation. This is because removal activities are critical to meeting our emissions reduction targets and will continue to play an important role in future targets.

*Policy work is also progressing on other mechanisms to incentivise a higher level of afforestation and other complementary removals*

- 69 Alongside proposed changes to the NZ ETS, existing policy or new complementary policy measures could be put in place to incentivise emissions reductions or removals. Work is proposed, or currently progressing, on several such mechanisms, including:

69.1 **A redesigned permanent forest<sup>4</sup> category in the NZ ETS** is being developed. The aim of the redesigned category is to support forests to deliver positive long-term outcomes as part of our climate transition, while also providing for wider environmental benefits, and supporting both Māori and our rural communities. Subject to Cabinet approval, consultation on proposals to redesign the category will be joint with the NZ ETS review and begin in June. This work is closely linked with the review as the price incentives for entering the permanent forest category may be significantly altered depending on the outcome of the review. It is therefore intended that these two work programmes will be consulted on at similar times.

69.2 **A voluntary carbon market for removal and mitigation activities.** A framework for how a domestic voluntary carbon market could work in Aotearoa New Zealand is being developed. <sup>9(2)(f)(iv)</sup>

69.3 **Exploring a biodiversity credit system** that either supports incentives for specific types of removal activities or help to align the incentives in a newly designed permanent forest category.

- 70 The Minister of Forestry and Minister of Climate Change have commissioned a carbon removal strategy to coordinate and prioritise efforts and investment

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<sup>4</sup> NZ ETS eligible post-1989 forest land that is not clear-fell harvested for at least 50 years.

across government, the private sector, and communities to support new removal activities. It will address key questions such as how many removals we need to complement ambitious gross emissions reductions, what types of removals are prioritised, and how new removal activities can be recognised and rewarded over time. It will also consider how biodiversity, climate resilience and broader co-benefits could be realised.

### ***Consultation will take place over eight weeks***


#### *Consultation timeframes*

- 71 We propose that consultation for the NZ ETS review takes place over an eight-week period from mid-June to mid-August 2023.
- 72 We propose consultation for the NZ ETS review be joint with the redesign of the permanent forestry category. The release of consultation materials and public meetings, as well as public communications, will be aligned. This will be important given decisions on the future balance of emissions reductions incentivised by the NZ ETS would have implications for forestry.
- 73 It is important for consultation to begin in June and conclude in August. The NZ ETS review discussion document includes time-sensitive information that will enable and support effective participation in the NZ ETS market. This is of particular importance to entities intending to bid in the September and December NZ ETS auctions, as the information will help inform bidding strategies and the provision of collateral.


#### *Iwi/Māori engagement*

- 74 Given the significant effects on Māori across New Zealand and the strong interest of Māori in the NZ ETS and its review, it was decided that officials would engage with Māori representatives early on in the policy process, prior to the public consultation period.
- 75 Due to NZ ETS market sensitivity, early engagement was limited to key pan-Māori national representative bodies under a non-disclosure agreement. Our Treaty analysis informed our decision to engage with National Iwi Chairs Forum (NICF), the Federation of Māori Authorities (FOMA) and Te Taumata Māori Forestry Landowners Collective (Te Taumata).
- 76 Officials are progressing an ongoing relationship with Pou Take Āhuarangi (climate change), Pou Taiao (environment) and Pou Tahua (economic) from the NICF, signing a memorandum of understanding (MoU) to support collaboration across NZ ETS and land use policy. Officials will engage with Pou Chairs at key decision points throughout the NZ ETS review (alongside engagement on other related workstreams).
- 77 Ministers and officials have also had a number of meetings with FOMA and Te Taumata representatives to seek their input. Most recently, on 23 May the Minister of Climate Change hosted meetings with the Chairs of the three NICF Pou and, separately, with FOMA.

9(2)(g)(i)



81 Ongoing engagement with NICF, FOMA and Te Taumata (if forthcoming) will inform, and be supplemented with, broader engagement with Māori as part of public consultation on the NZ ETS review and permanent forestry category redesign. 9(2)(f)(iv)



82 Officials have developed a detailed stakeholder engagement plan that targets NZ ETS participants, forestry interests, groups leading rangatahi climate change action and iwi and hapū. Consultation is planned to include online briefings and some regional face-to-face hui.

*Legal issues (section subject to legal privilege)*

9(2)(h)



### **Financial Implications**

86 There are no financial implications from the decisions in this paper.

### **Legislative Implications**

87 There are no legislative implications from the decisions in this paper.

88 However, the review could lead to legislative changes to the Climate Change Response Act 2002 in the future.

### **Impact Analysis**

#### *Regulatory Impact Statement*

89 The Quality Assurance panel with members from the Ministry for the Environment (Chair), the Treasury and the Ministry for Primary Industries has reviewed the discussion document and confirms that it substitutes as an interim Regulatory Impact Statement. The discussion document is likely to lead to effective consultation and support the delivery of Regulatory Impact Analysis to inform subsequent decisions. The panel noted the discussion document contains relatively limited information on implementation and the

quantum of impact, though notes that in-principle decisions will not be sought as a result of this consultation and next steps are still to be developed.

### *Climate Implications of Policy Assessment*

90 As this paper contains no regulatory proposals, a Climate Implications of Policy Assessment is not required.

### **Te Tiriti o Waitangi implications**

91 We note the Treaty partnership obligations under te Tiriti o Waitangi to act reasonably and in good faith. This includes undertaking reasonable steps to understand the interests of affected Māori, the likely impact of the proposal on affected Māori, and any active steps the Crown is required, or intends, to take to protect the affected interests of Māori.

92 There are particular obligations towards specific Māori groups and iwi, set out in instruments such as settlement deeds, relationship agreements and legislation. For example, some Māori groups/iwi and the Ministry for the Environment have agreed to early engagement on NZ ETS matters in relationship agreements.

93 Māori engagement must be facilitated in a way that ensures legal obligations are honoured and discharged, including as Treaty partner and those set out in settlement deeds, relationship agreements, and legislation.

94 A Māori rights and interests and te Tiriti o Waitangi analysis alongside advice from specialist Māori engagement experts will support this. Meaningful consultation requires providing consulted persons with adequate time and opportunity to understand the proposals and provide a response.

### **Population Implications**

95 As this paper does not seek final decisions, there are no immediate impacts on population groups.

96 The proposals in the discussion document will be significant for Māori. Māori have expressed strong interests in an effective climate change response, and have significant interests in the NZ ETS review as rangatira, kaitiaki, land and forest owners, workers and business owners, taxpayers, and everyday consumers who buy products that have the cost implications of carbon built into the price.

97 The options considered through the NZ ETS will impact household costs due to the flow-on impacts of the NZU price; Māori households are estimated to experience a slightly larger than average impact than the average Aotearoa New Zealand household because they are disproportionately represented amongst lower-income households.

98 The options will also have implications for returns from different land-uses, with options impacting the incentive for and profitability of forestry in different ways. Māori freehold and Māori customary land is disproportionately on

remote, less versatile land and there are considerable challenges raising capital on this land. Carbon revenue from exotic forests provides an important opportunity for development and investment and Treaty settlement entities own significant forestry assets. Māori have strong cultural connections with and multiple uses for native forests.

- 99 The review also considers whether the NZ ETS should incentivise more indigenous forests and other nature-based solutions. These could provide opportunities for Māori to exercise kaitiakitanga and support restoration and protection of ngāhere as well as the cultural practices and mātauranga they support.

## **Human Rights**

- 100 As this paper contains no policy proposals, it has no impacts on human rights or interactions with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

## **Consultation**

- 101 This paper was prepared by the Ministry for the Environment, the Ministry for Primary Industries and the Ministry of Business, Innovation and Employment. The following agencies were consulted on this paper: the Treasury, the Ministry of Foreign Affairs and Trade, the Ministry of Transport, the Department of Conservation, Te Arawhiti, and Te Puni Kōkiri. The Department of the Prime Minister and Cabinet was informed.

## **Communications**

- 102 The review of the NZ ETS was publicly announced alongside the emissions reduction plan and confirmed in March 2023. We expect stakeholders and the public to be interested in the NZ ETS review, as well as its implications. It will be important to provide them with as much information as is practicable, in as simple a form as possible given the complex and technical nature of the review.
- 103 When publicly communicating about the review, it will also be important to ensure the Crown acts in accordance with the principles of te Tiriti. Officials are planning targeted in-person hui with Māori in different regions, and will continue to engage with the NICF, FOMA, and Te Taumata throughout public consultation.
- 104 Further communications of the NZ ETS review, including the release of the discussion document, need to be managed carefully to avoid any market risks, including sudden impacts on the emissions unit price.
- 105 It will be important to align the communications for the review and permanent forest category redesign. Officials will ensure communications for each topic align, as they will be presented to stakeholders at the same time.



106 We intend to release the discussion document and commence the consultation in mid-June 2023 on a date to be confirmed in consultation with the Prime Minister's Office.

### **Proactive Release**

107 We intend to proactively release this paper on the Ministry for the Environment's website, subject to redactions as appropriate equivalent to those under the Official Information Act 1982, once public consultation has begun.

### **Recommendations**

The Minister of Energy and Resources, the Minister for the Environment, the Minister of Forestry and the Minister of Climate Change recommend that the Committee:

- 1 **Note** that the New Zealand Emissions Trading Scheme (NZ ETS) will play an important role in achieving Aotearoa New Zealand's climate change goals, including our Nationally Determined Contributions (NDCs) under the Paris Agreement and our domestic emissions budgets and 2050 target;
- 2 **Note** that in its advice *Ināia tonu nei: a low emissions future for Aotearoa*, the Climate Change Commission (Commission) recommended the Government amend the NZ ETS to strengthen incentives for gross emissions reductions and to manage the amount of exotic forest planting the scheme drives, in line with its advice on the emission reductions and removals needed to meet emissions budgets (recommendations 11.1 and 25.2a);
- 3 **Note** the Commission recently released its draft advice for the second emissions reduction plan, which recommended amending the NZ ETS to achieve specific levels of gross emissions reductions in emissions budgets two and three, and separating the incentives for emissions reductions and removals in the NZ ETS (proposed recommendation 3);
- 4 **Note** that, under the Climate Change Response Act 2002, in preparing an emissions reduction plan and supporting policies and strategies for an emissions budget period, the Minister of Climate Change must consider the advice received from the Commission for meeting emissions budgets;
- 5 **Note** that Cabinet previously agreed to prioritise gross emissions reductions in the emissions reduction plan, alongside maintaining support for net emissions reductions, in line with the Commission's analysis and advice on emissions budgets [DEV-21-MIN-0277];
- 6 **Note** that, as part of the first emissions reduction plan, Cabinet agreed in principle to the Commission's recommendations to amend the NZ ETS to strengthen the incentives for gross emissions reductions and manage the amount of exotic forests driven by the scheme, subject to the outcomes of a targeted review of the NZ ETS [CAB-22-MIN-0152];
- 7 **Note** that the definition of 'prioritising gross' being proposed for consultation is incentivising the uptake of low-emissions technology, energy efficiency

measures, and other abatement opportunities as quickly as real-world constraints allow’;

- 8 **Note** that the definition of ‘maintaining support for net emissions reductions’ being proposed for consultation is ‘driving levels of removals sufficient to help meet our climate change goals in the short-to-medium term and to provide a sink for hard-to-abate emissions in the longer term’;

*Consultation on the NZ ETS review*

- 9 **Note** that the current design and settings of the NZ ETS are expected to:
- 9.1. deliver significant removals, predominantly through exotic afforestation
  - 9.2. drive limited gross emissions reductions deliver significant removals, predominantly through exotic afforestation
  - 9.3. result in limited native afforestation;
- 10 **Note** that the expected outcomes of the current design and settings of the NZ ETS (see recommendation 8) suggest the NZ ETS needs to be amended to prioritise gross emissions reductions and maintain support for removals, subject to feedback from public consultation;
- 11 **Agree** that the discussion document will seek feedback on four options to incentivise greater gross emissions reductions through the NZ ETS, while maintaining support for net emissions reductions:
- 11.1. Option 1: Use existing NZ ETS levers to strengthen incentives for net emissions reductions;
  - 11.2. Option 2: Create increased demand for removal activities to increase net emissions reductions;
  - 11.3. Option 3: Strengthen incentives for gross emissions reductions by changing the incentives for removals;
  - 11.4. Option 4: Create separate incentives for gross emissions reductions and emissions removals;
- 12 **Agree** to release the appended discussion document New Zealand Emissions Trading Scheme Review for an eight-week public consultation from 19 June to 11 August 2023;
- 13 **Note** we propose to publicly consult on the proposals to redesign the permanent forest category in the NZ ETS, alongside this consultation on the NZ ETS review;
- 14 **Agree** to delegate approval of any minor or technical changes to the discussion document to the Minister of Forestry and the Minister of Climate Change;

- 15 **Note** that the changes referred to in recommendation 14 are likely to include updates to the discussion document's description of early engagement with key pan-Māori national representative bodies (following feedback from the National Iwi Chairs Forum and the Federation of Māori Authorities);

*Next steps for the NZ ETS review*

- 16 **Agree** that, following public consultation, the Minister for Energy and Resources, the Minister for the Environment, the Minister of Forestry and the Minister of Climate Change will report back to Cabinet when appropriate on the outcomes of consultation and advise on next steps of the NZ ETS review;
- 17 **Note** the government has committed to engaging with the National Iwi Chairs Forum technicians from Pou Take Āhuarangi, Pou Taiao and Pou Tahua to support collaboration across NZ ETS and transitional forestry issues, and are also committed to engaging with Te Taumata Māori Forestry Landowners Collective (Te Taumata) and the Federation of Māori Authorities (FOMA) alongside wider engagement with Māori;
- 18 **Note** that, to support the approach in recommendation 15, the Ministers responsible for the NZ ETS review will be expected to engage with key Treaty partners (for example, Pou Chairs) at key decision points (including the announcement of the review and the finalisation of the discussion document, as well as throughout consultation and before final Cabinet decisions);
- 19 **Note** that a Tiriti analysis is being carried out and will be referenced alongside the Cabinet report back;
- 20 **Agree** to proactively release this paper on the Ministry for the Environment's website when public consultation begins.

Authorised for lodgement

Hon Dr Megan Woods

Ministry of Energy and Resources

Hon David Parker

Minister for the Environment

Hon Peeni Henare

Minister of Forestry

Hon James Shaw

Minister of Climate Change

# **Appendix A: Discussion document - Te Arotake Mahere Hokohoko Tukunga | Review of the New Zealand Emissions Trading Scheme**

## Appendix B: Recent consultations related to climate and the NZ ETS

	<b>Topic</b>	<b>Dates</b>
1	Ministerial Inquiry into Land Use	March – April 2023
2	Improving market governance of the NZ ETS	November 2022 – February 2023
3	Assurance over climate-related disclosures: occupational regulation and expanding the scope of assurance	November 2022 - February 2023
4	Pricing agricultural emissions	October – November 2022
5	National direction for plantation and exotic carbon afforestation	October – November 2022
6	Proposed changes to NZ ETS limits and price control settings for units for 2022	September – October 2022
7	Changing the surrender/repayment penalty for small forestry participants in the NZ ETS	August 2022
8	Adapt and thrive: Building a climate-resilient Aotearoa New Zealand (national adaptation plan)	April – June 2022
9	Proposed changes to regulations for the NZ ETS 2022	April – May 2022
10	Managing exotic afforestation incentives by changing the forestry settings in the NZ ETS	March – April 2022
11	Shape the emissions reduction plan	October – November 2021
12	Reforming industrial allocation in the NZ ETS	July – September 2021
13	Designing a governance framework for the NZ ETS	July – September 2021
14	Proposed NZ ETS and synthetic greenhouse gas levy regulation updates 2021	April – May 2021
15	Phasing out fossil fuels in process heat	April – May 2021
16	Reforming the NZ ETS: Proposed settings	December 2019 – February 2020
17	NZ ETS: Modelling the electricity allocation factor	November – December 2019
18	Reforming the NZ ETS: Rules for auctioning	November – December 2019
19	Climate-related financial disclosures: Our proposals, your views	October – December 2019
20	Action on agricultural emissions	July – August 2019
21	Proposed technical updates to NZ ETS regulations for 2019	May – June 2019
22	Zero Carbon Bill	June – July 2019
23	Proposed technical updates to NZ ETS regulations for 2018	May – June 2018
24	Consultation on proposed improvements to the NZ ETS	August – September 2018