GROWING PROSPERITY AND POTENTIAL

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Submission on reforming industrial allocation in the New Zealand Emissions Trading Scheme.

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To MFE via etsconsultation@mfe.govt.nz

Overview

1. Thank you for the opportunity to submit on this important topic for the emissions intensive and trade exposed businesses in New Zealand. The proposal comes up with options to reduce a perceived problem of "over allocation" of industrial units to firms that are highly emissions intensive, and trade exposed. The rationale for industrial allocation to these firms was designed to keep them globally competitive and to avoid emissions leakage to other countries that do not regulate or otherwise put an equivalent price on emissions.

2. Climate change is a global issue. There is no benefit from emissions moving from an energy efficient country to an energy inefficient country that uses significantly more carbon intensive energy to produce the same products. In addition, if New Zealand designs a scheme that is effectively an exit strategy for these products to be made in New Zealand profitably, then assuming the products are still needed in the future they will need to be imported, which is additional emissions to get them here, not to mention setting us up for strategic supply chain vulnerabilities of the sort that we are seeing currently with Covid19. For example, we note that most of the steel produced by NZ Steel is sold in New Zealand, and there is a whole ecosystem of downstream manufacturers and construction companies that rely on that locally made product. If key products are no longer manufactured in New Zealand, there could be serious implications on the security of supply, keeping import prices honest and delivery delays associated with lead in times and shipping issues which would affect NZ's economic resilience.

3. We submit that emissions leakage remains as significant a risk as when the ETS was first established. Only one fifth of global emissions are priced.[1] That low level of coverage coupled with low average prices and huge variation between international schemes (in terms of sectoral coverage, surrender rules, unit price/supply policies, unit market controls and transitional support policies, including allocation, rebates and financial payments)[2] means there is no current or emerging level playing field for New Zealand businesses to compete with overseas manufacturers. Industrial allocation is therefore still necessary to provide a level playing field and prevent emissions leakage.

4. *"Sense Partners (2018) found the NZ ETS had not impacted significantly on the competitiveness of EITE producers to date. However, emission prices were very low for a long period and EITE producers received considerable free allocation. The report noted uncertainty about the future impact of emissions pricing under rising domestic emission prices and declining levels allocation, alongside uneven target ambition and emissions pricing in other jurisdictions under the Paris Agreement.*

The ETS has already been strengthened

5. Our concern with the proposal to shift baselines and revised eligibility for industrial allocation is that there have been significant changes already to the New Zealand ETS to increase its impact (e.g. price floor increased, price ceiling increased and a legislated phase out of assistance out to 2050). The price of units in the NZ ETS has gone from $25/tonne in 2019 to $65/tonne in 2021 and future prices 5 years out are up in the $ 70/tonne region.

6. EITE businesses are often affected by other changes in energy markets and greenhouse gas policy, making them less competitive. For example, energy prices have increased due to shortages of natural gas; the Electricity Allocation Factor review will compound the ongoing phase out of industrial allocation; and local manufacturing of coal has no future because of the eventual ban on use in low-medium temperature processes. Business NZ supports the premise that emissions from fossil fuels need to be eliminated, however at the same time the impact on EITE businesses needs to be recognised, who in many cases currently have no alternative to fossil fuel use. In some instances, the pressure on fossil fuel supply will increase the price for biomass because of supply shortages, further reducing competitiveness of EITE if they were able to source capital for investing in a fuel switch.

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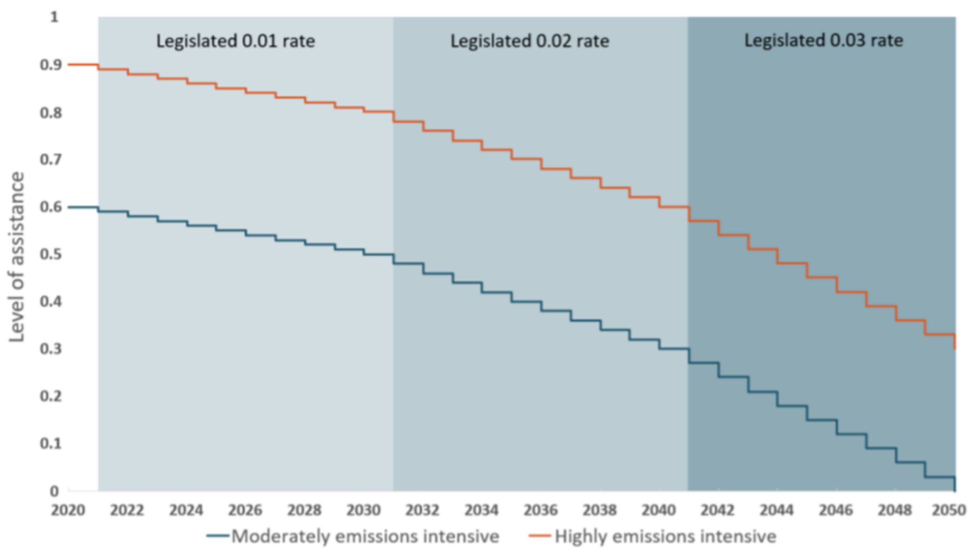
1 World Bank. 2021. "State and Trends of Carbon Pricing 2021" (May), World Bank, Washington, DC. Doi: 10.1596/978-1-4648- 1728-1. License: Creative Commons Attribution CC BY 3.0 IGO

2 For example, we understand that emissions intensive firms in the EU still enjoy subsidised power prices and there is $100 billion fund for the steel industry to assist with a "just transition". Also, in a recent critique of the EU ETS by the European Court of Auditors, shows firms at risk of carbon leakage get 100% industrial allocation (not tied to their ability to pass through the costs) out to 2030. We attach a copy of the report as an Appendix.

7. If (on top of these changes) baselines and eligibility, for industrial allocation are changed and are going to continue to change, then that is just making it harder for these firms to stay competitive and attract investment into industrial activities. Picking a baseline year with which you measure your emissions intensity, rewards the business for any emission reductions it can make from that baseline. Businesses have a strong incentive to reduce emissions and any income that can be made from that industrial allocation can be used to invest in further emissions efficiencies. A robust industrial allocation system is an elegant solution to keeping firms on a path to continual investment and R&D into lower emission ways of operating. If you don't use a market solution such as this, then the Government would need to look at the transitional support and investment other governments are making, such as the $100b fund for a just transition for steel firms in the EU (obviously to the scale needed in NZ). A market solution as we have currently is much preferred as it gives predictability for firms to invest in solutions if ETS design parameters remain stable. Changing of industrial allocation eligibility and baselines undermines the incentive to invest in emissions reductions, because any gains will be taken away.

8. It is the view of BusinessNZ that the ETS is being undermined by a whole plethora of complimentary measures that are unnecessary, that increase Sovereign Risk to investing in New Zealand and which will ultimately result in worse policy outcomes, both for the climate and for the economy. Moderate and highly emissions intensive trade exposed firms will face the full cost of emissions policy by 2050 and 2060 respectively, but investment and business decisions regarding those businesses exiting the NZ market will be made well ahead of that date.

Figure 1: Phase-out of the level of assistance for moderately and highly emissions-intensive activities



The ETR Act also enabled the Government to increase the phase-out rates for individual activities after 2025, and decrease them after 2030, based on the recommendations of the Climate Change Commission.

9. BusinessNZ is of the view that the MFE should be very clear about the impacts of climate policy on our EITE firms and the impacts of their exit from New Zealand, for both the global climate and for the New Zealand economy.

10. BusinessNZ recommends that given the small amount of industry that get the majority of the Industrial Allocation, it should not be too hard a task to do a detailed analysis of their value to the New Zealand business ecosystem, and the downside of not having them here. Not just for employment, revenue, taxes paid and export receipts, but for the local manufacturing and food sectors they support. We are currently experiencing the supply chain cost and uncertainties thrown up by Covid19 disruptions and we could, as a geographically isolated Country, make some big strategic mistakes by making the wrong choices about what it is we make in New Zealand into the future. As a geographically isolated country, New Zealand needs be resilient and self-reliant by retaining key production and manufacturing activities. If we are on target to hit our emission reduction targets and budgets, we should stay the course via the least costly route.

Catherine Beard

Executive Director

BusinessNZ