

7 August 2024

Hon Simon Watts  
Minister of Climate Change

## Key messages

- a we support your approach to climate policy. Your least-cost, net-based approach, signalling no big changes to the ETS and keeping targets constant will strengthen credibility and market confidence;
- b the last six years of political leadership have left our energy sector in damage control. Natural gas is vital in helping to achieve emissions reductions targets, and we believe the Government will need to do more heavy lifting to steady the ship in this crucial window of opportunity;
- c the threat of industry leaving New Zealand's shores is real and near and brings with it the risk of emissions leakage, best managed with free allocation in the ETS, not a tariff, and the five-yearly allocation review should be removed;
- d a key role for government is to set early and enabling regulation, standards and specifications for emerging fuels and technologies; and
- e sector specific policies in the draft ERP2 are mostly appropriate but will require careful evaluation of their effectiveness and connection across sectoral boundaries.

## ***A slow and steady approach is best for the climate and economy***

1. We wish to congratulate the Government on its commitment to a least-cost, net-based approach outlined in the draft New Zealand Second Emissions Reduction Plan (ERP2). While informed by science, climate change is an economic issue and the net burden imposed on the economy as we address it should be minimised.
2. We are starting to see companies and countries moving away from their own targets. For example, *Air New Zealand* recently announced it would abandon its

2030 carbon intensity target,<sup>1</sup> and Scotland abandoned its statutory 2030 climate goal.<sup>2</sup> Speculation abounds that other countries will do likewise (such as Canada and Australia), or at least maintain their targets but fail to achieve them.

3. We encourage consistency for all climate policy, including keeping our 2030 Paris Agreement target and our 2050 net zero target unchanged.
4. We are also pleased to see that adaptation features in your strategy. This is long overdue. If you are giving consideration to changing our Nationally Determined Contribution (NDC) as per the UNFCCC process for 2025 (as set out in the Paris Agreement), we suggest you extend the scope of the NDC so that it is more consistent with the purpose of the Paris Agreement as set out in Article 2, which specifically includes mitigation, adaptation, food security *and* sustainable development (which in turn could include energy security and resilience).<sup>3</sup>
5. This revised scope would allow New Zealand to:
  - a showcase its ambition across a wider set of dimensions; and
  - b refocus on a more coherent, realistic and systemic approach across our actions to address climate change while achieving energy resilience and economic prosperity rather than a siloed or blinkered focus on mitigation alone - a problem suffered by the last government.
6. We also note that the IPCC, IEA and New Zealand scientists agree that outdated scenarios underpinning climate research and assessments are informing poor policy decisions and increasing costs of climate change mitigation. Yet councils, consultants, and groups funded by government continue to proliferate them. It is time to abandon implausible worst-case scenarios, such as RCP8.5.

### ***Gas is needed for the transition and to keep industry in New Zealand***

7. Natural gas is a critical fuel in our low emissions journey and its supply is diminishing, in large part because of the political upheaval dealt to the gas sector with the ban on new exploration. Reversing the ban is one part of the solution but we suspect government may need to play a part in making further exploration less risky.
8. We would not normally encourage government intervention, but the failure of government policy has exposed the gas market to underinvestment and an intolerable level of sovereign risk. With demand currently not being met, and coal

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<sup>1</sup> See <https://www.stuff.co.nz/travel/350360018/air-nz-dumps-2030-carbon-intensity-reduction-target>.

<sup>2</sup> See [Scottish government scraps climate change targets \(bbc.com\)](https://www.bbc.com/news/scotland-56888888).

<sup>3</sup> We note that the UNFCCC website describes NDCs as embodying “efforts by each country to reduce national emissions and adapt to the impacts of climate change.” See <https://unfccc.int/process-and-meetings/the-paris-agreement/nationally-determined-contributions-ndcs>.

replacing gas for electricity generation again this winter and probably next, the situation is serious and needs urgent attention.

9. In these economically challenging times, deindustrialisation is a real and proximate threat, especially for firms relying on natural gas. Diminishing gas supply and sharply rising energy prices are two of the most important factors in industrial decision-making right now. Even with stable policy settings, you may see closures of firms that have suffered from previous policy decisions and there will be domino effects.

### ***Carbon Capture, Utilisation and Storage is a valid and valuable technology***

10. We strongly encourage a technology neutral approach to emissions reduction and are relieved to finally see Carbon Capture, Utilisation and Storage (CCUS) featuring as a key opportunity for emissions reduction in the draft ERP2, along with enabling renewable gases.
11. In its most recent work of the AR6, the IPCC has included CCUS as a necessary option in transitioning the energy sector, and wider society and the economy in general, to a low carbon future. The global potential for CCUS is vast and Governments should be acting with urgency to adopt enabling frameworks to reduce barriers to its uptake. CCUS was also recognised by all 190+ UNFCCC parties at CoP28 as a necessary abatement technology in need of acceleration.
12. New Zealand's potential for CCUS as an emissions reduction and removal technology is real and it needs rapid support through regulation, but its main benefits for firms will be economic. In the appropriate circumstances, the ETS must reflect the emissions captured to appropriately account for the carbon removed. This has remarkably been done already for geothermal firms and we expect the same for natural gas.<sup>4</sup>
13. You will be aware of a number of criticisms and risks associated with CCUS which we argue are mostly myths. The environmental risks, such as captured carbon emissions 'escaping', are extremely low and avoidable.
14. One other such myth is that CCUS could increase demand and thus increase emissions. Yet, demand (and supply) is influenced by many factors, including the availability of substitutes (which there clearly are, like electricity) and the actions of competitors. This myth also demonstrates a lack of understanding of the 'waterbed effect' in an ETS operating under a fixed cap.

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<sup>4</sup> Recall that as previously noted, the application of CCS to the oil and gas sector is *not a removal*, but an avoided emission and therefore we do not think that changes to the ETS are relevant for oil and gas producers unless they are storing carbon received from a third party. However, the ETS is absolutely relevant to the capture of carbon post combustion from industrial processes.

15. We will be providing details to debunk these and other myths in our submissions on the draft ERP2 and CCUS, which we will provide to your office for information on completion.

***The Emissions Trading Scheme needs less tinkering, and emissions leakage is best managed with free allocation***

16. The ETS has been subject to constant and material ‘tinkering’ over the past few years leading to unnecessary and destructive volatility. Key to this has been its direct undermining by complementary measures such as the now abandoned GIDI and EV subsidies. We support your government’s direction for ETS policy to make it more predictable and stable.
17. Consistent with this we consider that free allocation of NZUs should remain largely unchanged. We note that work is underway to ensure free allocations more accurately reflect emissions by firms receiving them, with new regulations to be published later this year. We urge the Government to take a cautious approach to any changes to the allocation of NZUs as this could undermine the incentive to take action (such actions tend to be financed by the units they ‘free up’, and reducing the allocation of units creates the real risk that firms hold off on the very investments needed to reduce emissions, thereby creating a the first-mover disadvantage) and prevent the risk of emissions leakage.
18. The five-year discretionary review introduced in 2023 creates a similar risk and should be removed as soon as possible. We understand that officials advised against it, but it was included at the previous Climate Change Minister’s insistence. See our 2023 submission here.
19. We note that ERP1 contained an implicit instruction for further work on industrial allocation by investigating a domestic Carbon Border Adjustment Mechanism (CBAM).<sup>5</sup> A CBAM introduces a number of risks to a small export dependent economy like ours and can only ever be a partial solution, offering protection to domestic industries who face import competition. We have no visibility of where this work is currently at but think it is an unwelcome distraction and should be terminated if it is not the policy of this Government.

***Publicly funded, private sector lobby groups lack integrity***

20. There were a number of groups established under the previous government with mandates to develop climate advice. The draft ERP2 for example, mentions the Sustainable Aviation Aotearoa group. This group was set up under the instruction of ERP1 and has government officials working alongside industry representatives on three working groups. We are aware of at least one of these groups having

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<sup>5</sup> ERP1, Action under Focus area 4: The risk of emissions leakage: action 5.4.2 Investigate long-term options to address emissions leakage. Proposed output: Assessment of emissions leakage risk in Aotearoa and long-term policy options to address any risks. The cement sector will be investigated initially. Cabinet decisions here: <https://www.taxpolicy.ird.govt.nz/-/media/project/ir/tp/publications/2022/2022-ir-cab-22-env-22-sub-0011/2022-ir-env-22-sub-0011-2-paper.pdf?modified=20220822233252>

self-selected its members to support particular policies such as mandates and locking out those that might argue against them.

21. For probity and good governance reasons, it is not appropriate to have government officials working in what is essentially an advocacy role in these working groups especially when they are investigating rent-seeking policies such as mandates and publicly funded supports which are not the policy of the current government.<sup>6</sup>
22. We recommend you urgently review the governance, funding and value of these (and similar) groups and withdraw direct government involvement from them at the earliest opportunity.

***Proceed with caution on proposals for funding and financing climate mitigation***

23. We note there is work underway to unlock private investment and remove barriers for funding and financing climate mitigation and promoting biodiversity, the basics of which are outlined in the draft ERP2. It is good that work is underway to address investment barriers.
24. The creation of new regimes such as voluntary carbon and biodiversity credit markets is welcome, but their design needs to be thoughtful, especially with regard to the interaction with the compliance market. The added complexity would need to provide substantial benefits that outweigh administration, and compliance costs and protect consumers from paying avoidable premiums.

***Transport policies (EV charging, heavy vehicle transition funding) need to demonstrate good value for public money***

25. In our view, the core role for government involvement in transport sector climate policy is to set appropriate and timely standards and specifications for emerging fuels and technologies. There is some public funding in the transport section of the draft ERP2, which has been well signalled and is temporary. We would not usually endorse technology specific policies such as funding for privately provided EV chargers or electric trucks. However, given these policies were announced as part of the National party's election campaign and were confirmed in Budget '24, the focus should be on good value outcomes.
26. One of the greatest risks when executing such policies is that they 'crowd-out' private sector investments. It is therefore good to see that the draft ERP2 includes options for review of the effectiveness of these policies, although this should be the standard practice.
27. We are pleased to see the policy option for supporting reductions in international aviation and shipping is for the government to facilitate industry discussions.

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<sup>6</sup> We note from ERP1 this is group was explicitly established to focus on research and development of decarbonisation initiatives for aviation, which included work on a government mandate.

Public funding of \$765,000 from the previous government for two feasibility studies on domestic production of sustainable aviation fuels now needs to produce good public value. Further funding cannot be justified.

28. We support the government's approach to innovation and R&D, so long as any future support is timely, temporary and targeted, modest, and technology neutral.

***Fuel specifications consultation is overdue***

29. We think it is urgent for MBIE to release its overdue consultation on fuel specifications. Updated specifications will enable immediate economic and environmental benefits through improved market access to renewable fuels and efficiencies. This is not part of the ERP2 consultation though it has the potential to be. It is one of those policy areas that cuts across the energy and transport portfolios, so it is important that you and your Ministerial colleagues are aligned and purposeful to get these and other similar regulatory changes underway.

***The sectoral approach to emissions reduction is practical, but ultimately unrealistic***

30. The emergence of new fuels and technologies increasingly blurs the boundaries between sectors. Bioenergy is a good example of this, where forestry, energy, waste and transport sectors all have some involvement. Again, the role for government will be to align and provide coherence between the various actors, funding streams, timelines and priorities. Early and enabling regulation will be critical.
31. It will be important not to fall into the 'reductionist'<sup>7</sup> rabbit hole of the previous government, by thinking that simple approaches will have the effect intended. We saw this with ERP1, and its long list of interventionist policies focused on gross emissions. It is great to see a much shorter list of potential policies for ERP2.

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<sup>7</sup> The practice of analysing and describing a complex system wide phenomenon in terms of its simple or fundamental parts, especially when this is said to provide a sufficient explanation.