



# Frequently Asked Questions: NZ ETS unit limits and price control settings for 2025–2029

## About this document

These FAQs relate to He Pou a Rangi Climate Change Commission’s 2024 advice on NZ ETS unit limits and price control settings, for the years 2025–2029. Our [full report](#) and [accompanying media release](#) are available on our website. For more information, please contact [media@climatecommission.govt.nz](mailto:media@climatecommission.govt.nz).

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## How does the NZ ETS work and what does it do?

- Under the NZ ETS, certain companies and entities are required to give units to the Government for their emissions every year.
- These units can be bought from Government auctions, created from forestry, and in some circumstances are available for free.
- For the NZ ETS to work well, the units in the scheme need to decline in line with the declining emissions reduction targets.

## What is the scope of this advice?

- Every year, the Government needs to decide on how many units to auction.
- Before they do this, we give the government advice including on how many units to auction, as well as advice on price guardrails.
- Our advice aims to help line up the units in the scheme with the declining emissions reduction targets.
- This year, we have also raised concerns about wider issues outside the scope of this work, but that could compromise the effectiveness of the scheme.

## Does the Government have to accept the Commission's advice?

- Our role is to provide independent, evidence-based advice regardless of the government of the day.
- The Government can choose what to do in response when it updates the settings.
- If it takes settings that differ from our advice, it needs to be clear about why, so this is transparent and it can be held to account.
- The Government's choices need to add up. It has to meet the requirements of the Climate Change Response Act that the NZ ETS settings accord with emissions budgets, the 2050 target and the Nationally Determined Contribution (NDC). If it adopts different settings, it will have to show how its settings fulfil those statutory requirements.

## What happens next?

- Next, the Government will consider our advice and run a public consultation on proposals, led by the Ministry for the Environment on behalf of the Minister of Climate Change. This is in the second quarter of 2024.
- The Government must make decisions on NZ ETS unit limits and price control settings in time for the regulations to be updated by 30 September 2024. The new settings will come into force on 1 January 2025. We expect to provide our next advice on this topic, for the period 2026–2030, in the first quarter of 2025.

## Could the Government's decisions on NZ ETS settings be judicially reviewed again?

- The right to apply for judicial review through the High Court is an important part of a healthy democracy.
- In July 2023, the NZ ETS settings that were previously in regulations were reconsidered and updated, following settlement of a recent judicial review brought against the New Zealand Government.
- As a Crown entity, we expect our work to be robustly assessed in accordance with the appropriate legal standards, as should be expected of any government work.

## Why is the Commission saying there are too many units in the NZ ETS?

- For the NZ ETS to work well, the units in the scheme need to decline in line with the declining emissions reduction targets.
- A large number of units have built up in the scheme; this risks allowing too many emissions.
- New data and information has become available since our last advice. We found:
  - More forestry units have entered the market. While these units are new to the scheme, they were earned for carbon stored in previous years that has already been counted towards targets to reduce emissions.
  - Some units that were already in the scheme are more available for use by market participants than we previously thought.
- No units were sold at government auctions in 2023, indicating the market had sufficient supply.
- Our updated recommended unit limits reduce auction volumes by around 20 million units over the four years of 2025-2028 compared to the unit limits currently in regulations.
- Making these changes helps maintain stability for the scheme and ensure it is working as effectively as possible under its current structure.

## What's the difference from last year's NZ ETS settings advice?

- On the unit limits, we have assessed that there are too many units in the NZ ETS and so have recommended that the Government reduce NZ ETS auction volumes as soon as possible.
- We have assessed that the surplus units in the scheme – which present risks to meeting emissions budgets – have increased from our 2022 estimate of 49 million to 68 million units now.
- The new recommended unit limits reduce auction volumes by around 20 million units over the four years of 2025-2028 compared to the unit limits currently in regulations.
- Our recommended changes to unit limits are due to updating our analysis with new data and information that has become available since our last advice. We have applied the same methodology as before to develop the unit limit recommendations, with only minor refinements.
- This year we recommend only minor adjustments to the price control settings to reflect the latest information on expected inflation. Otherwise, we consider that the price control settings remain fit-for-purpose.

## Why has the surplus increased since the Commission's last advice?

- The surplus has accumulated over many years for a range of reasons. But there are two main causes of the recent increase to our central surplus estimate:
  - A large increase in units allocated for forests registered in the NZ ETS, due to a combination of the end of a mandatory emissions reporting period for forestry and the registration of over 200,000 ha of forests into the NZ ETS in 2022<sup>1</sup>
  - Updated data indicating that the several million pre-1990 forest allocation units<sup>2</sup> in the market are more liquid than previously assumed. In other words we have assessed them as more likely to be used for emissions (surrenders) over the next few years, rather than held long term by those who received them.

## Why do the forestry units recently given out risk not meeting targets? Aren't they offsets?

- There is a mismatch in the timing of how carbon dioxide absorbed by forests is counted towards national emissions reduction targets and how foresters earn them in the NZ ETS.
- For targets, the carbon dioxide that forests absorb is accounted for in the year that it occurs.
- The NZ ETS does not work this way. Units can be given out for the carbon dioxide removed by forests up to five years ago, and these units can be used for surrenders at any time in the future.
  - For example, emissions returns for forests registered in the NZ ETS were due in 2023 for the previous five year reporting period (2018-2022). These forests could then be allocated units dating back to 2018.
  - This means many forestry units that entered the market in 2023 relate to carbon dioxide removals that occurred prior to the beginning of Aotearoa New Zealand's current emissions reduction targets (before 2021 for the NDC, or before 2022 for the first emissions budget).
- The effect of these units, if they are available for use by emitters, is no different from other units in the market – which is to enable further emissions, rather than to offset them.

## Why does the Commission advise changes to the unit limits from 2025?

- The Climate Change Response Act strikes a balance between supporting regulatory stability and allowing changes to the settings when necessary for the NZ ETS to fulfil its purpose - of helping New Zealand reduce emissions to meet its targets.
- Normally, we only advise on changes to settings for the last two years of the regulations already in place, and on adding an extra year on the end. But the Act provides that in certain circumstances that all years' settings can be amended.
- This year we judge that the increased surplus estimate meets the bar of allowing changes to all years of the unit limit settings. So we have advised on changes from 2025 onwards.

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<sup>1</sup> There is usually a significant number of units allocated at the end of forestry mandatory emissions reporting periods. For the most recent reporting period (2018-2022) this was further exacerbated by over 200,000 ha of post-1989 forest registering into the scheme in 2022, as these forests could be allocated units for removals going back to 2018. While some forestry units that have entered the market will be held for future harvest obligations, a share is likely to be available for use by other NZ ETS participants to enable their emissions.

<sup>2</sup> These are units that were allocated to owners of pre-1990 forests on a one-off basis in the early years of the NZ ETS, as partial compensation for loss of asset value due to the deforestation liability on pre-1990 forests.

- Specifically, we consider that the increase to the estimate of surplus units in the scheme is a change that significantly affects the proper functioning of the NZ ETS. The increase in the surplus means the current regulations no longer align with emissions reduction targets.

## What are the wider issues with the NZ ETS that the Commission is raising and asking government for policy direction on?

- There are ongoing gaps in Government policy that affect the NZ ETS and create uncertainty for market participants.
- We cannot make recommendations on them in this advice, but we raise them as they undermine the ability of the NZ ETS unit limits and price control settings to serve their purpose.
- If these issues remain unresolved, it will become increasingly difficult to accord the NZ ETS settings with emissions reduction targets in future.
- There is opportunity for the Government to address those issues in the next plan for reducing greenhouse gas emissions (due December 2024, covering the five years of 2026–2030).

### **NZ ETS related issues for the Government’s consideration in its second emissions reduction plan include:**

- *Government decisions on the goals for reducing emissions at their source and using forestry to absorb carbon dioxide.* In our advice on the second emissions reduction plan, we recommended that the Government commit to specific levels of gross emissions for the second and third emissions budgets and provide indicative levels of gross greenhouse gas emissions and carbon dioxide removals out to 2050 and beyond, to guide policy decisions.
- *How the Government will use the NZ ETS to deliver the outcome it wants in terms of reducing emissions (at their source) and using forests to absorb carbon dioxide.* The NZ ETS risks initially encouraging high rates of forest planting in a way that displaces emissions reductions. It will also not be able after the mid-2030s to provide the durable incentives for the forests needed to get to net zero long lived gas emissions by 2050 and every year thereafter. These likely effects of the current NZ ETS structure mean that if the Government wants to reduce emissions as much as possible as well as encourage the forests needed to get to net zero long lived gas emissions, it will either need to amend the NZ ETS, or implement other policies.
- *Clarifying the plan to achieve the country’s first nationally determined contribution (NDC).* Aotearoa New Zealand will need to use emissions reductions from other countries to meet the NDC, but the Government has not yet secured access to any. If the Government wishes to speed up domestic emissions reductions to reduce the need for reductions from other countries, it will need to spell out how this will work. There is an opportunity to use the NZ ETS and complementary policies together to do this, but direction is needed from the Government about whether this is the approach it wants to take.

## How has the Commission aligned the NZ ETS to the Nationally Determined Contribution (NDC)?

- The Climate Change Response Act requires the Minister to align the NZ ETS settings with emissions budgets, the NDC and the 2050 target. The settings do not have to precisely align with emissions budgets and the NDC if there is a good reason for a difference.
- One issue is that these three targets are all set at different levels so a choice has to be made as to how to best align with them.
- The NDC is set at a more ambitious level than emissions budgets, beyond what New Zealand can feasibly achieve domestically. So part of the NDC will need to be met by Aotearoa New Zealand helping other countries to achieve emissions reductions (by funding “offshore mitigation”).
- The NDC was set on the basis that overseas reductions would be used as part of meeting it. Later work by the Commission (in *Ināia tonu nei* 2021) and government officials (Treasury and MfE’s 2023 Climate Economic and Fiscal Assessment report) also indicates that a significant amount of offshore mitigation will be needed.
- The NZ ETS is not the only way the Government could obtain overseas reductions. It could purchase them itself, rather than devolving the purchase of international units to NZ ETS participants.
- The Government has not yet secured access to overseas reductions for meeting the NDC, or made decisions about the role of the NZ ETS in delivering it. The scheme remains domestic-only as the Government has not approved any overseas units for use in the NZ ETS.
- For these reasons we again this year advise that the NZ ETS settings should align with emissions budgets as the stepping-stones to the 2050 target and the domestic contribution to the NDC.
- It is urgent that the Government clarify its plans for meeting the NDC. The viability of the current approach to the NZ ETS settings relies on the Government making progress on a credible plan and securing overseas emissions reductions for meeting the NDC.

## Wouldn’t it be better to fund emissions reduction at home than pay for emissions reductions overseas?

- If done in the right way, funding emissions reductions overseas can be a valuable contribution to the global effort on climate change.
- Partnering with developing countries on emissions reductions can help New Zealand meet its NDC while improving the lives and environment for people in those countries.
- Some developing countries will have emission reduction opportunities which are out of their reach, but to us would be considered low cost.

## What is the cost impact of the NZ ETS on consumers?

- Over the longer term, the evidence is that the economy will grow and households will be better off from the transition to a low-emissions, climate resilient Aotearoa New Zealand.
- In the shorter term, modelling undertaken by the Treasury helps to illustrate the relative potential impact of changes in the NZ ETS emissions price across various levels of household income.
- This modelling should not be used as a projection of costs as it assumes full pass through of costs, and that people’s behaviour does not change and low-emissions technology does not emerge in response to the emissions price.
- To estimate potential distributional impacts, the model isolates what an increase in the emissions price could mean for households. The most recent analysis (from 2022) found that:
  - A \$10/tonne change in the emissions price could result in just under a 70 cent impact on low-income households per week, and a \$1.50 impact on high-income households per week.
- Some households and businesses will be less able to take up lower-emissions alternatives, like heat pumps or electric vehicles. We advise that instead of constraining the NZ ETS to address impacts they face as a result, the Government uses other tools such as targeted support.

## What does the Commission’s advice mean for the NZ ETS auction scheduled for 20 March 2024?

- That auction will proceed as per the regulations in place for this year, which our advice does not affect.
- It wouldn’t be appropriate for us to comment on what the outcome of the auction might be. It’s the role of the market and market participants to find the price.

## Quick facts about the revised surplus estimate

	Commission’s NZ ETS settings 2022 advice (July 2022)	Current advice (2024)
Total units held in the registry	145 million	161 million units
Central surplus estimate	49 million units	68 million units
Estimated surplus range	33 – 66 million units	51 – 84 million units

## Factors contributing to the increased 2024 surplus estimate

Our estimate of units considered surplus in the market has increased by around 40% this year, due to some historical issues. These relate to: 1) Units being allocated from planting in past years 2) Flows of units that were given out as compensation when the ETS was first set up.

- Our central surplus estimate has increased since our previous advice by 19 million (m) units.
- There are several factors feeding in to the 19 m unit increase, with quantities that have changed in the calculation of the surplus including:
  - An increase to post-1989 forestry units contributing to the surplus of around 8 m units. This is due to a net increase of post-1989 forestry units in the NZ ETS of 14 m units while the estimate of units held for harvest liabilities has only increased by around 6 m units (up to 58 m now from 52.2 m in 2022).

- A decrease in our estimate of pre-1990 forestry allocation units that will be held long term out to 2030, of around 7 m units.
- A decrease to estimated units held for hedging by non-forestry participants of around 2 m units.
- The change to the overall volume of units held in the registry, which in addition to the 14 m net increase in post-1989 forestry units (noted above) was also affected by the units sold at auction in 2022 combined with lower than forecast emissions surrenders in 2023.

**Figure 6: Comparison of our previous and current estimated breakdown of unit holdings in private accounts (the stockpile)**

