

6 April 2011

ETS Review 2011 Consultation
Ministry for the Environment
PO Box 10362
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Dear Panel Members

Emissions Trading Scheme Review

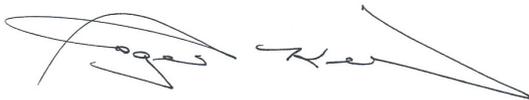
1. We commend the Review Panel for releasing the Issues Statement for consultation and for producing an informative document. We have three initial comments on its contents:
 - There is no recognition of the economic context in which the Review is taking place. New Zealand is facing very serious economic challenges. Productivity growth is weak, unemployment is high, there is a pressing need for economic rebalancing to reduce external vulnerabilities, and the impact of the Christchurch earthquake has knocked business confidence and resulted in weak growth forecasts. The economy is in no position to absorb additional cost burdens. Additional burdens would run counter to the government's goals of rebalancing the economy (which would be hampered if the traded goods sector were to face higher costs) and increasing economic growth to catch up to Australian income levels by 2025.
 - The paper appears to take the stated intentions of trading partners (eg Australia and the United States) at face value. The government made this mistake in assuming that Australia would proceed with the Carbon Pollution Reduction Scheme, only to find that it was aborted. In many countries public opinion polls and government actions indicate diminishing support for costly climate change measures. We do not believe that the Panel should confidently proceed on the basis that, for example, Australia will proceed with its plans as reported in the Issues Statement (or that they would survive a change of government), or that the US Environmental Protection Agency will succeed in implementing its regulatory plans.
 - Decisions concerning the options the Panel is considering should be based on net national benefit considerations. Because New Zealand makes a negligible contribution to global emissions, the benefits of adopting mitigation measures are primarily international relations benefits and protection of our commercial interests. The costs are reductions in New Zealanders' actual or potential material living standards. We think the Panel needs to state clearly in its report what it sees as the rationale for the Emissions Trading Scheme and consider whether intensification of measures after the transitional period (or even their maintenance at current levels) is justified in net national benefit terms.
2. We note and acknowledge that the Panel is not to focus on:
 - whether New Zealand should be taking action on climate change, and
 - whether an ETS is the most appropriate response.

However, to provide context for the comments that follow, we would record that our position on these issues at the time the government was taking decisions was:

- that New Zealand should not take additional action in advance of our major trading partners, and
 - that while a market mechanism is generally superior to regulation, a carbon tax, as favoured by a majority of international economic experts, is superior to a trading scheme. A carbon tax which could evolve into a trading scheme if a liquid international market developed was favoured by the Australian Productivity Commission. (The fixed price and half obligation option adopted by the government has some of the properties of a carbon tax.)
3. With respect to the matters to be addressed by the Panel, we wish to make selective comments rather than respond comprehensively to the questions posed in the Issues Statement.
 4. Broadly, we think that New Zealand remains out in front on carbon pricing due, in part, to inaction by other countries. We see the forthcoming report by the Productivity Commission in Australia on the relative efforts of a number of countries, including New Zealand, as shedding light on this issue. Due in May, it should be a valuable input into the Panel's deliberations. An important point to make is that New Zealand should not seek to adopt the average carbon pricing levels of other Annex I countries because it is a less wealthy country. The UNFCCC and the Kyoto Protocol recognise that less wealthy countries should not be expected to make the same efforts as wealthier ones. The Issues Statement notes that Singapore, a much wealthier country than New Zealand, has made support for carbon pricing conditional on an international climate agreement. It should also be noted that the level of any international carbon price is not necessarily indicative of relative economic burdens (as the costs of mitigation opportunities differ).
 5. Of the possible international trading scenarios from 2012-2020 outlined in the Issues Statement, we consider that Scenario 1 (a legally binding multilateral framework) is unlikely and that Scenario 3 (medium-term uncertainty and continuing multilateral discussions) is more likely. On this basis, we believe the conditions will not exist in 2012 for the transitional measures to be removed on schedule. There is a serious risk that New Zealand industries could be exposed to a high carbon price. This argues for an extension of the fixed price and two-for-one surrender obligation. An extension until the 2014 review would be one option, but because investment horizons will be much longer in some cases we think the Panel should consider the merits of a longer extension. Moreover, if the Australian Productivity Commission analysis suggests that New Zealand has taken on a disproportionate burden, relative to its per capita income level, the impact of the scheme should be reduced. The estimates of costs presented in the Issues Statement are not insignificant.
 6. Along with freezing the status quo, we think that the agriculture sector should be fully brought within the scheme in 2015 as scheduled. The date of entry of agriculture has already been extended once. With agriculture accounting for around half New Zealand emissions, it is inefficient and distorting for the burden of emissions reductions to be borne by other industries or taxpayers (they might face roughly twice the burden for a given level of reductions). One distortion concerns land use competition with forestry, and we note that no protection is available to pre-1990 forest owners. While there may be limited short-term options for reducing agricultural emissions, this is also true of other industries. Indeed the Ministry of Economic Development study of business responses to the ETS reports (p71) that "What this study has found is that for most businesses there is an expectation that there are limited cost effective abatement options." We consider that the Panel and the government should not be making judgments as to where abatement opportunities lie. The whole point of a market mechanism is to identify these in an efficient manner rather than to have some central authority 'pick winners'. If a 'winner picking' approach were to be taken to agriculture it should logically be applied to other industries with perceived limited abatement opportunities. We would be opposed to such an approach on the grounds that carve-outs would lead to generalised special pleading for exemptions and undermine the integrity of the scheme. Nor is the exclusion of agriculture by other countries a reason for exclusion by New Zealand: liquid fossil fuels would also be excluded on that basis.

7. Naturally any elements of the agricultural sector that are trade-exposed should be treated in the same way as other trade-exposed industries. Consistent with our view that the status quo should be frozen we consider the government should not proceed with any phase-out of free allocations pending the 2014 review. We are also aware of a view that agriculture and other trade-exposed industries are not being properly shielded by the allocation system, and that food processors are unduly penalised, and we urge the panel to consider whether design aspects of the scheme need to be reformed.
8. The approach outlined in paragraphs 6 and 7 above is similar to the 'broad base, low rate' approach to tax policy. Logically, with a widening of the base (consistent with the 'all sectors, all gases' approach of the government), the rate (ie the fixed price) could be reduced to maintain a comparable emissions reduction effort.
9. We attach importance to the following matters to be reviewed by the Panel:
 - Potential linkages to overseas emissions trading schemes. Officials and the government proceeded with the ETS on the basis that New Zealand would be able to meet its obligations at least cost through significant offshore purchases of units. We query whether this assumption is valid. Among other things, the current Australian proposal is to introduce a fixed-price mechanism for an extended period (which would exclude trading).
 - The costs and benefits of establishing an independent allocation agency. The ETS is the equivalent of a tax in terms of government revenue and we have been concerned about risks associated with its administration (as with import licensing). That is one reason why we have favoured a carbon tax administered by an independent tax authority.
 - Administrative efficiency including transaction costs. We are aware of concerns that the administrative and compliance costs of the ETS are high, particularly when assessed on a cost per unit reduction in emissions. We are pleased that the Panel will investigate this issue. Estimates of the number of persons involved in the operation of the scheme and associated costs in both the public and private sectors would be valuable, as would any recommendations by the Panel on how these costs might be reduced. It is unfortunate that the Panel is unable to consider whether the government's objectives could be achieved with lower transaction costs by replacing the ETS with a carbon tax.
10. A potentially important element of climate change policy that does not feature in the Issues Statement is 'no regrets' measures that are justified in their own right but would also contribute to emission reductions. An example might be road pricing policies. This may be a matter that the Panel could consider.
11. We would appreciate the opportunity to discuss this submission with the Panel. We have no objection to its release.

Yours faithfully



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