



Beyond Copenhagen:
Implications for Business

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1. INTRODUCTION

- 1.1 Now that the dust has settled, it is timely to take a retrospective look at the Copenhagen COP 15, its outcome, and its implications for New Zealand business. This paper looks at what emerged from Copenhagen, some of the factors that led to this, and what could be expected to develop over the next year, and why. On the basis of this assessment, it also outlines some initial suggestions for business over the next year.

2. SUMMARY

- 2.1 It is easy to fall to using slogans (“Hopenhagen to Brokenhagen”) and to dismiss the COP as an unmitigated failure. However, based on my participation at the COP, I believe that there is a richer story to be told that belies black or white characterisations.
- 2.2 International negotiations are complex but global climate change negotiations are intensely complex. This proved to be the case. But a failure of process does not necessarily imply a failure *per se*. Copenhagen can be assessed as an adjustment of expectations. The change of pace implicit in the Copenhagen Accord is a political and economic reality check on what could be perceived as over-ambitious environmental objectives.
- 2.3 More progress is both desirable and achievable. Significant break-throughs at Copenhagen such as China’s commitment to international verification on developing country commitments should not be under-estimated. But much remains to be settled including those rules that would benefit New Zealand’s circumstances.
- 2.4 Our view is that the developed country consensus that emerged at Copenhagen now more than ever suggests that the speed, direction and process of future change will be determined by the US, and whether the US can first commit to domestic action to limit its emissions and then reach an agreement with China. Momentum towards a form of global agreement will emanate from this point. The road forward is unlikely to be straight-forward, and whatever progress is made needs to be viewed by New Zealand through an emissions trading scheme lens. It is this that will dictate our view of success or failure and, in turn, our suggestions to business.
- 2.5 Irrespective of the form of the process, evidence of significant progress towards an international agreement that results in a widespread adoption of a cost of carbon is needed by the end of this year. This will breathe life into New Zealand’s domestic policy settings. Concerns about carbon leakage will abate but the fact that a price of carbon flows through our economy from 1 July 2010 but not through those of our trade competitors needs to be addressed now.
- 2.6 Should there be no such evidence, the on-going veracity of a uniquely stringent emissions trading scheme may come into question. In these circumstances, a shift to other measures that better match the cost of action with the commercial benefits is likely to be warranted. These actions are likely

to be driven by business giving customers what customers want – sustainable, low carbon goods and services, and not driven by a cost of carbon.

3. A CLEAR FAILURE OF PROCESS

- 3.1 Obviously no multi-lateral agreement that committed countries to legally binding emission reduction targets emerged from the COP. Given that this was a widely perceived (though wildly unfounded¹) expectation of the COP, by this *process* measure, the COP was a failure. This failure of process, while important and needing to be resolved, neither validates those who consider the exercise of negotiating emission reductions unnecessary, nor those who might consider that more stringent targets need to be agreed by developed nations.
- 3.2 Much has been made of the ‘two-track’ process via which the negotiations were occurring and how that contributed towards the process failure (the two-tracks being the Ad hoc Working Group on Long-term Co-operative Action (the AWG-LCA, the non-binding track for developing nations, plus the US as a non-Kyoto Protocol signatory), and the Ad hoc Working Group on Further Commitments of Annex I Parties under the Kyoto Protocol (the AWG-KP, for parties with binding commitments).
- 3.3 While the two-track process undoubtedly contributed to the sense that the negotiations were unwieldy, if not unmanageable, success in bringing developing countries into a common regime, would have made the fact there was two negotiating tracks less relevant. The expectation (at least by developed countries) was that the US – as a party only willing at best to agree to voluntary action - would be used to carry the substance of whatever was agreed in the context of the AWG - Kyoto Protocol around monitoring, verification and reporting, into the AWG – LCA. This occurred to some extent.

4. WHAT HAPPENED AT COPENHAGEN?

- 4.1 However, before writing Copenhagen off as a complete failure, it is important to look beyond the process difficulties to matters of substance. Let’s look first at why the process failed and then whether these matters of substance also warrant the nomenclature of failure.
- 4.2 Putting aside the wildly over-optimistic expectations that had arisen prior to Copenhagen, three key factors inexorably drove towards the outcome reached at Copenhagen. These were:
 - a) the US turned up without a domestically-agreed proposition. Fundamentally, a large measure of the success of this COP was dependent on an agreement between the US and China. However,

¹ It is important point to note is that there was never going to be anything binding with respect to emission reduction targets come out of Copenhagen. Not if it was expecting to involve either the US or China. Given its embarrassing Kyoto Protocol experience, the US was never going to sign up to a treaty that bound them to specific targets (even though they were happy to put forward reductions targets). And neither was China because it wanted to maintain the two-track, developed (Annex I)/developing (non Annex I) distinction that required only Annex I countries (including the US) to commit to binding emission reduction targets.

without domestic legislation, the US had nothing it could commit to, even in a voluntary sense;²

- b) despite all of the environmental rhetoric, negotiators knew (or quickly came to realise) that this was not an environmental negotiation with economic consequences but an economic negotiation with environmental consequences. With promises of vast sums by way of international support to aid developing countries in undertaking mitigation being demanded by developing countries (the final amount in the Accord is \$30billion between 2010-12 moving up to \$100billion per year by 2020³), expectations of commensurate and verifiable action by developed countries were similarly high; and
 - c) the concept of the 'tragedy of the commons' loomed large at the COP. While willing to take action, Annex I countries were united in the view that all countries had to take action to reduce emissions. It was recognised that continuing to focus on the level of binding commitments from Kyoto Protocol signatories would fail to hold temperatures at anywhere near those suggested as necessary by the IPCC Panel (2 degrees).⁴ Developing countries preferred to place the blame for global warming on to developed countries.
- 4.3 However, before translating these factors into a view of the success or failure of Copenhagen, there is a non-Copenhagen factor through which the Copenhagen outcome must be viewed. This factor is the New Zealand emissions trading scheme. The new, moderated scheme became law on 7 December 2009. With its passage into law, the emissions trading scheme became only the second legally binding scheme in existence (second only to the EUETS), but the most stringent and comprehensive (all gases, all sectors).
- 4.4 On the face of it, the link between a domestic emissions trading scheme and the international climate negotiations is tenuous. The details of New Zealand's domestic trading scheme were set in law with only the detail of allocation to be worked through. While the possibility of a more ambitious emissions reduction target (as reflected in the quantity of Assigned Amount Units allocated to New Zealand) was a potential outcome, its likely impact would have been a cost borne by the Crown, or the development of regulatory interventions aimed at reducing emissions (i.e. measures that had a 'shadow' but not a market price of carbon).
- 4.5 Unfortunately, this is an over-simplification, and one (to their credit) recognised by officials involved in the negotiations process. From 1 July 2010, New Zealand will have a price of carbon flow through the economy. This price

² Much was made of China sending an official to the last-minute negotiations led by the US and how it was a snub of the US. My take on it is that it was more consistent with ensuring that the Chinese Premier avoided a loss of face from being associated with an outcome that was unable to be sealed with an agreement between China and the US.

³ Though the \$100 billion pa amount is described as a "goal".

⁴ Indeed, the Hon Tim Groser was heard to comment that in all of his years as a trade negotiator, he had never seen such a degree of unanimity around an issue.

(albeit 'moderated' by the price cap, the progressive obligation and the free allocation offset) is, nonetheless a price of carbon on every marginal unit of production for those who face the obligation.

4.6 A delay by other countries to accept emission reduction pathways, and reflect this by putting a price of carbon on their output has two main implications for New Zealand:

- a) it threatens the on-going competitiveness of New Zealand business as local firms (who would otherwise be competitive) face competing product prices that do not reflect a cost of carbon; and
- b) it creates price risk. Scheme participants are only able to import ERUs/CERs or use domestically generated NZUs. While the Crown has via the price cap, effectively taken on the up-side price risk through to the end of 2012 (the end of the Kyoto Protocol), without more widespread trading the market would be neither deep nor liquid. Both of these characteristics are necessary to the discovery of the efficient price of abatement. The worst-case is the default New Zealand cost of abatement (which, given New Zealand's agriculturally-dominated emissions profile is likely to be much higher than an efficient global price of abatement).⁵

4.7 It was, undoubtedly, these factors that were in mind when Government set the conditions to its 2020 emission reduction target, most notably conditions:

- i the global agreement sets the world on a pathway to limit temperature rise to not more than 2°C; and*
- v there is full recourse to a broad and efficient international carbon market.*

4.8 Let's turn now to translating these factors into a view of the success or failure of Copenhagen. This translation is a New Zealand-centric assessment from a business perspective and is set out in the following table.

⁵ Analysis by NZIER/Infometrics found that if we do not get similar action from other countries in putting a price on greenhouse gas emissions in terms of coverage, timing of entry and free allocation, then the cost to New Zealand increases by 33% at \$25/tonne and by 50% at \$100/tonne CO₂e or \$8,400 per year in reduced income for a family of four. This is likely to be exacerbated should there be no recourse to a liquid international carbon market.

Factors that could signify success	Factors that could signify failure
<ol style="list-style-type: none"> 1. no agreement by New Zealand to a quantified emission reduction target. New Zealand's 2020 target is still subject to the suite of conditions. This preserves New Zealand's options; 2. developed country consensus around their preference to have an agreement with broad coverage (even within acceptance of "common but differentiated responsibility") instead of a narrow agreement that only imposed high economic costs on those with binding targets while yielding little or no environmental benefit; 3. acceptance by developing countries of international consultation on verification of mitigation actions; 4. the emergence of a more moderate set of emission reduction expectations combined with an on-going commitment to work through the outstanding issues; 5. the requirement of the verification of developing countries emission reduction commitments before financing; 6. acknowledgement of use of markets (amongst other mechanisms) to meet commitments in a least cost manner; and 7. substantial progress towards improved forestry rules (to deal with, for example, the offsetting rule problem) and the explicit acknowledgement of food security concerns 	<ol style="list-style-type: none"> 1. the key factor relates to delay. Delay can manifest in a number of guises, all related to emissions trading: <ol style="list-style-type: none"> a. no agreed emission reduction targets (particularly from our trade-competitors) means no pressure to price carbon, no progress to develop and implement carbon trading schemes, leaving New Zealand competitively exposed; b. little progress was made with revamping the Clean Development Mechanism (which gives rise to CER units) or the development of a successor arrangement for a post-Kyoto world. With an operative trading scheme that is in deficit, with high domestic abatement costs, New Zealand needs to have a reliable flow of fungible units entering the global market; c. no clarity about what to do with Eastern European economies surplus AAUs (while there is little prospect of these becoming available to New Zealand businesses, the Government could still access them if sufficiently cheap); and d. no conclusion to the on-going debate about whether there should be limits on the use/importation of some units instead of domestic action (a particular problem given our emissions profile); and 2. the uncertain nature of final 'agreement' and the process going forward could yet mean that any gains on forestry rules and agriculture could be lost in future negotiations

4.9 In light of the above, the outcome of Copenhagen could be described as a "qualified success".

5. WHAT NEXT FOR A GLOBAL AGREEMENT?

5.1 Despite the ambition surrounding COP-15 there remain four outstanding 'headline' issues which need to be resolved, these being:

- a) resolution of the Kyoto issue (replace, extend, or modify);
- b) transparency in the monitoring of mitigation measures;
- c) the role of markets (both broadly, as well as specifically in terms of new mechanisms and options⁶); and
- d) the details and conditions of financing packages.

5.2 None of these areas are trivial and each comes with a myriad of detailed issues that remain outstanding. For example, some of the outstanding issues under the AWG KP are the base year for targets, the duration of the next commitment period (e.g. 5 or 8 years) and emissions from international aviation and shipping.

5.3 Essentially, the Copenhagen Accord is of dubious legal standing (having only been "noted" by the conference), and the mandates of the two tracks (AWG KP and AWG LCA) have been extended. The status of the work undertaken under each of these two tracks is "nothing is agreed until everything is agreed". This means that issues previously addressed can re-emerge.

6. IS THERE A CIRCUIT-BREAKER?

6.1 What will move things forward? Put simply, some form of agreement between the US and China. Such an agreement will be likely to dictate both the form and process.

6.2 However having said that, the US inability to pass domestic legislation will probably act as a permanent break on the international process that contains legally binding emission reduction targets. This legislative block doesn't preclude a new legally binding agreement with *voluntary* reductions (a 'pledge and review' type model) emerging post-Copenhagen, but it is not at all clear that even this could happen without domestic US legislation (for the reasons discussed above concerning China's reticence). US domestic politics will ultimately decide this and at the moment, the possibility of climate change legislation is looking improbable.⁷

⁶ Such as the incorporation or not of carbon capture and storage into the CDM or its successor arrangement. This proposal was declined at Copenhagen but its importance was recognised and it will continue to be debated.

⁷ It is useful to note that the US President has alternatives to a new cap-and-trade scheme passed by Congress. The Supreme Court has ruled that the EPA can regulate greenhouse gas emissions and the Administration has started the process of doing so. And the States of the east and west are still moving on regional schemes. This is important on two fronts. First, it allows the President to offer something into a "promise and verify" international set up and second, it might get some moderate republican to back cap-and-trade, on the grounds that a consistent set of national standards are better than an ad hoc set of partial Federal and state rules (some of the US business lobby groups are of this opinion).

- 6.3 As noted above, this (a legally binding agreement with voluntary reductions) was the best that could have been hoped for from Copenhagen. If it does happen, it will be likely to emerge from the 'bottom-up' - the G20 or Major Emitting Group of Economies. Getting 190-odd countries in a room to thrash out a text will be unlikely to be tried again. Such a process is not without risk to New Zealand (if the rules are going to be set by a smaller club, how do we make sure we are either members or that we have a good agent among the rule-setting members?)
- 6.4 An broader-based agreement (or whatever it may be called) will coalesce around a China-US consensus. Whether the pledges to reduce emissions are internationally enforceable/binding (as opposed to domestically) or not now appears less relevant than whether it encompasses all countries.
- 6.5 However, a potential chicken-and-egg situation exists, as a 'bottom up' process won't work without a 'top down' process to make everyone commit to the process and 'top down' is unlikely to work unless everyone has done their 'bottom up' bit which they won't.
- 6.6 Therefore, some work is going to have to be done on the international architecture, and a 'translation' of some variety of the 'bottom-up' into the formal UN process (similar, but hopefully more successfully that what occurred at Copenhagen with the accord being hammered out by the group of five countries) is likely to be necessary to formalise it.
- 6.7 Should such a 'translation' not occur, at a minimum, in order to be credible, any agreement would need to pick up the detailed technical rules and a framework for monitoring and verification. Without these rules, any such agreement would be likely to dissolve as no country could be certain of the delivery, by others, of their commitments.

7. HAS DETERMINATION TO PURSUE A BROAD-BASED OUTCOME EVAPORATED?

- 7.1 No. But the issues outlined above have certainly cribbed the expectations of some to achieve an ambitious agreement. In our view, the progress (or lack of it) made at Copenhagen reflected a significant reality check on the aggressive pursuit of uncertain environmental outcomes for high economic cost.
- 7.2 As an aside, while not directly impacting on the outcome of the negotiations, the renewed level of scrutiny of the veracity of the IPCC reports were almost inevitable and, in fact, are likely to become stronger. This is consistent with the desire of developed countries to ensure that if they are to impose significant costs (including the financing of developing countries) on their respective economies, that the underpinnings of doing so are robust.

8. IS THERE AN INTERNATIONAL 'PLAN B'?

- 8.1 Yes, but it is problematic.
- 8.2 Most commentators will accept that 2010 will be a critical year in the process of climate change negotiations. As noted above, the US is pivotal in terms of the extent to which progress will be made towards a global agreement.
- 8.3 Our assessment is that given the likely difficulties regarding US domestic legislation, the chances of a broad-based international agreement being settled quickly are receding. Whether this is the eventual outcome will become clearer by the end of 2010. Even if progress is made, it is possible that a successor to Kyoto will not be in place by the end of 2012.
- 8.4 Should no broad-based international agreement be forthcoming, it is possible that we will see the emergence of voluntary regional carbon 'bubbles' (e.g. EU, Australasia, North America). Should regional 'bubbles' emerge their success will depend on the extent to which there is co-ordinated and credible monitoring and verification mechanisms within their participants, and the breadth of participating countries.
- 8.5 The ability to implement effective mechanisms across borders raises significant issues on unit homogeneity and fungibility. Given this, it is possible that even regional bubbles will not be in place by the end of 2012. Given the difficulties of implementing effective mechanisms, the real risk emerges of countries committing to, but not delivering on, carbon emission reduction commitments. Such an arrangement is unlikely to be sustainable and akin to there being no arrangement.
- 8.9 While the real prospect of New Zealand formally linking with another scheme is low (in the case of Australia, driven by the need for the CPRS to get across the line in the first instance, and then the need for Australia to actually see a link with New Zealand as beneficial), linking is not a panacea in any case. Linking is only relevant if you are linked with your trade competitors, or your trade competitors are also facing a similar cost of carbon (such as the benchmark secondary CER price or domestic tax). New Zealand's exports to Australia account for approximately 20% of New Zealand's total exports and we import approximately 6% of Australia's export goods.
- 8.10 Given issues with the effectiveness of cross-border regional carbon 'bubbles' and breadth of participation, border adjustment tariffs are likely to gain traction in this world as countries who take action and impose a domestic cost of carbon seek to balance the competitive landscape. Such a world-trade environment would be unlikely to be good for New Zealand even if it was on the 'right' side of the carbon price equation.

9. WHAT DOES THIS MEAN FOR BUSINESS?

- 9.1 The clock is ticking if not on New Zealand's climate change policy framework per se then on its make-up. Given the outcome of Copenhagen, the nature of New Zealand's climate change policy agenda warrants careful assessment. Evidence of tangible progress towards the conclusion of an international, broad-based agreement to reduce emissions is needed by the end of 2010.
- 9.2 In our view, the international uncertainty, suggests a two-track approach. However, as with the need to temper any view on the success or otherwise of the international situation, so too must the approach to consideration of climate change policy be tempered by the presence of the Emissions Trading Scheme. With good, sensible and timely international progress, New Zealand business becomes less competitively exposed. But without it, the efficacy of New Zealand's domestic policy settings will become subject to extreme scrutiny with a realignment of current policy settings likely to be warranted.
- 9.3 The two-track process is summarised in the following table. The nature of much of how business may wish to engage in the policy debate is common irrespective of the particular track although its emphasis changes.

	Business Engagement		
A successor agreement	Review of emissions trading scheme to synchronise stringency with trade competitors	Facilitation of innovation and commercialisation of low carbon goods and services	Consistency from Government with stated conditions on emission reduction target
No successor agreement	'Fit-for-purpose' review of emissions trading scheme	Stronger facilitation of innovation and commercialisation of low carbon goods and services	

- 9.4 More detail of these two tracks is set out below. The particular elements are time sensitive. Timing is relevant because as it lapses, more information will come to hand that will inform the best position to adopt. This could include shifting focus from one track to the other.

Track One – A Successor Agreement is Negotiated

- 9.5 This track is based on the presumption that there is currently sufficient information to suggest that an international agreement (of whatever form) will be negotiated at some point. While clearly not a certainty, it would appear premature to conclude otherwise at this stage. A summary of track one is:
- a) there is no immediate reason for the repeal, or delay of the emissions trading scheme;

- b) immediate participation in the development of allocation regimes to suit current business circumstances (including the fact that New Zealand has an operational emissions trading scheme);
- c) the development and implementation of government frameworks that support, not hinder business leadership on the investment in low carbon goods and services; and
- d) in the medium term, engagement in the scheduled emissions trading scheme review (2011) and degree to which emissions trading scheme is synchronised with international action.

Should the ETS be Repealed or Delayed?

- 9.6 The emissions trading scheme, as implemented, has been done so on the basis that it is enduring (i.e. beyond 2012 but with mechanisms, such as the scheduled review in 2011, to further moderate or strengthen its impact if warranted) and the Government is working hard and in a determined manner to implement it.
- 9.7 Given these mechanisms, and the continued prospect of an international agreement of some form post-2012, it is our judgement that there is little point putting effort in *at this stage* on delaying the commencement of the Emissions Trading Scheme on *the basis of the international context*.⁸ This is reinforced by the fact that an international agreement is currently in place until the end of 2012 and New Zealand faces international obligations as a result of it which it is extremely unlikely to abrogate. Someone must meet the eventual costs of this arrangement. The Government appears satisfied that its new, moderated scheme strikes the right balance between taxpayers, businesses and consumers.

Making Sure that the ETS is fit for Current Business Conditions

- 9.8 The key issue is that New Zealand businesses will face a cost of carbon from 1 July 2010 while the majority of its trade competitors will not. Therefore, even with the prospect of a successor agreement emerge, the immediate focus should be on ensuring that the scheme is fit for the reality for New Zealand circumstances now and the competitive conditions in which New Zealand businesses will be operating from 1 July 2010.
- 9.9 Given this, it would be appropriate in the immediate term to be focused on the implementation of the allocation methodologies. These are currently being consulted on the Ministry for the Environment. The key element of this will relate to the need to avoid carbon leakage and import substitution risks. In the absence of other jurisdictions having emissions trading or carbon taxes, policy makers need to be extremely mindful of not locking in stringent allocation conditions into the New Zealand scheme now that assumes other countries will at some later time price carbon, or could afford New Zealand with a

⁸ This is not to say, however, that delay may be warranted on other practical grounds such as the improbable likelihood of allocation arrangements being able to be settled before the commencement of the scheme on 1 July 2010.

first-mover disadvantage as others who undertake similar activities in overseas jurisdictions (particularly Australia and Asia) match the degree of protection to suit their domestic economic circumstances rather than to New Zealand levels of protection.

- 9.10 We believe that that the impact of the allocation regime on trade-exposed, low carbon, high energy intensive food processors and manufacturers is a key issue under this heading.

A Note on the Impact of Uncertainty on Investment Decisions

- 9.11 The impact of the on-going uncertainty regarding the widespread adoption of a price of carbon should not be underestimated. With no international deal, and no prospect of widespread carbon pricing (particularly by New Zealand's trade competitors) there is likely to be a deadening effect on the drive to adopt new long-term abatement opportunities.
- 9.12 Unless driven by consumer preferences for low carbon goods and services whose investment yields a positive return, most businesses are likely to bear the new cost through to end of 2012 or until greater clarity emerges. In other words, in the short term, investment decisions which have the effect of reducing carbon will be driven more by the prospect of higher future revenue opportunities from the product market rather than by the avoidance of the carbon cost *per se*.
- 9.13 Ideally, an emissions trading scheme would also incentivise businesses to abate to avoid the new cost. But in the current uncertain environment, this is only likely to occur if abatement opportunities arise that are significantly cheaper than the price of carbon or they have a positive net benefit within a short timeframe. This being unlikely reinforces the need for business to focus on ensuring the effect of the emissions trading scheme in the short term is fit for purpose and measured in its application.

Facilitating Investment in New Low Carbon Goods and Services

- 9.14 A focus along the above lines (an initial pragmatic approach to allocation) is consistent with businesses seizing opportunities to take advantage of 'green' business opportunities, or investment in clean-technologies.
- 9.15 It is important to remember that these opportunities start with consumers and not emissions trading and a price of carbon. Therefore the opportunity for business leadership in delivering on customers' low carbon desires is immense. Work in biofuels, wind energy, transport solutions and others is happening apace. Such opportunities are being realised now, irrespective of a price of carbon, as businesses lead, or respond to changing business preferences towards low carbon, sustainable business practices. And we strongly support the pursuit of such market-led opportunities.⁹ This kind of

⁹ By way of tangible demonstration of such support, in November 2009 Business New Zealand and MORST hosted a workshop that brought major companies and leading science figures together with the objective of identifying sustainable business innovation opportunities utilising existing business infrastructure.

business demands more science, technology and skills, supported by good science and innovation frameworks and strong encouragement of government by business on these areas is likely to become increasingly important.

- 9.16 This is not primarily aimed at taking advantage of a carbon price as a price of carbon in New Zealand that has not been implemented in the economies of our trade-competitors does not make New Zealand leadership in the production of low carbon goods and services more likely. Instead it is aimed at the production of those goods and services which will make New Zealand business more efficient or in which they have a comparative advantage. These are measures with strong business cases that are not directly depend on the benefits of an international carbon price, but which deliver carbon reduction co-benefits, such as energy efficiency (primary benefit: energy security and healthy homes), and research and development targeted at areas where we have a comparative advantage such as the global agricultural research alliance (primary benefit: food security).
- 9.17 The medium to longer term expectation is that once an international agreement has been reached, and a carbon price is widespread, New Zealand producers will be prepared to take advantage of the uplift in demand around the world for the innovation and commercialisation of low carbon technologies.

Ensuring our ETS is commensurate to the actions taken by our trade-competitors

- 9.18 The short-term approach (that of protecting New Zealand's economic sovereignty now) should, if calibrated appropriately by policy makers, be appropriate for accommodating the uncertainty surrounding the timing of progress toward an international agreement. In other words, if our trade-competitors move quicker and more aggressively to price carbon than is anticipated, then the emissions trading scheme (specifically, the speed of the removal of free units), can be assessed at that time.
- 9.19 Policy judgement will therefore be required to assess how quickly it may emerge and what this means for domestic policy settings. A review of the Emissions Trading Scheme is scheduled for 2011. Unless information comes to hand sooner that warrants earlier advocacy, the review becomes critical as the means to test whether domestic policy settings continue to be commensurate with the benefits to New Zealand.
- 9.20 A robust review process will be vital to the success of the review.
- 9.21 If the prospect is of a delay of no more than a year or two in the broadening of a global trading market, successful short term regarding an appropriate allocation regime should help in this regard. However, in order to align with other schemes, additional policy work would be warranted to synchronise the timing of global action, for example, on:
- a) the extension of the scheme's moderating factors (the price cap, the progressive obligation); and

- b) deferral of the start date to the phase out of free allocation

Other Strands to Track One

9.22 Finally, there are three complementary strands to this track, these being:

1. the Government has recently signalled its intention to stick with its 10% to 20% target range (with conditions). Business needs to continue to hold the Government to the conditions it placed on what would be an acceptable international agreement for New Zealand. This is particularly important to New Zealand if the negotiations are driven out of a non-UN process (particularly where New Zealand is not 'at the table'). Adhering to the conditions is also critical to ensuring that a disproportionate cost is not borne by New Zealand. A corollary to this strand is that the Government also needs to seek other countries to adopt targets that increase the likelihood of the adoption of a price of carbon into their respective economies;
2. the development of a High-Level Business Statement to the Government before the next COP (November 2010) on what outcomes New Zealand business seeks from the negotiations. This Statement could include comments on such things as the role business can play in delivering on any outcome and the business conditions it needs to do so; and
3. in light of the experience of attending Copenhagen (the inability to access meetings due to the preponderance of environmental NGOs etc etc) our view is that attending future COPs as part of the official delegation is essential for there to be maximum value in continuing to have a business presence at them.

Track Two – No Prospect of an International Agreement

9.23 The focus of business on the nature of climate change policy is likely to change if it becomes clear during 2010 that a co-ordinated, global agreement is not going to follow-on from the expiry of the Kyoto Protocol. Track two is:

1. a substantive review of the emissions trading scheme and the implementation, where appropriate, of other measures.

9.24 If there is no prospect of an international agreement that leads to the widespread pricing of carbon, New Zealand businesses will be operating in a domestic environment that internalises a cost of carbon, but an international one that does not (or at least not in any global sense - as noted above, regional carbon 'bubbles' may emerge).

9.25 However, both scenarios (on the basis, as outlined above, that regional 'bubbles' are likely to be difficult to implement and problematic if implemented) are likely to place the on-going existence of an Emissions Trading Scheme even with moderating features and a declining profile of protection in an increasingly untenable position. In which case, a 'Plan B' is required from the

emissions trading scheme review. But this doesn't imply support for policy inaction. Instead, in a scenario of global inaction, other measures that better match the cost of action with the commercial benefits may still be warranted.

- 9.26 These measures - which could be additional to the energy efficiency and research and development measures referred to above as desirable in any case - may be necessary to forestall the imposition of border adjustment taxes by some of our trade competitors (though the risk of this could be small¹⁰). Such measures would likely be regulatory in effect, aimed at addressing market failures where the net benefits appear to outweigh the costs (i.e. strong business cases exist), and not depend on a cost of carbon but which deliver carbon reduction co-benefits. This could include additional targeted science and technology innovation support that facilitates business giving customers what they want – sustainable, low carbon goods and services.
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¹⁰ For example, New Zealand falls under the threshold set in the Waxman-Markey Bill.