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The voice of business

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Todd McClay
Chairperson
Finance Expenditure Select Committee
c/o Parliament Buildings
WELLINGTON

Climate Change Response (Emissions Trading and Other Matters) Amendment Bill

BusinessNZ is pleased to have the opportunity to provide a submission to the Finance Expenditure Select Committee on the Climate Change Response (Emissions Trading and Other Matters) Amendment Bill.[1]

Introduction

BusinessNZ welcomes the Climate Change Response (Emissions Trading and Other Matters) Amendment Bill and the changes to the New Zealand Emissions Trading Scheme (the 'NZETS'). The changes outlined in the Bill are needed to correct the premature roll-off of the two moderating features, and to reflect development (or a lack thereof) in the international climate change negotiations and the 2011 ETS Review Panel's recommendations.

Comments

BusinessNZ takes the view that what was thought to be a transitional period now seems permanent, or close to it. In other words, the current period of uncertainty is unlikely to be time-bound. This has important implications for the development of policy, its direction and pace. Therefore it is appropriate that caution is required rather than continuing to base policy on over-optimistic assumptions of international action in order to ensure that changes do not place a burden on business that is disproportionate to the costs faced by our trading partners (not just Australia), or are excessive at a time of global economic weakness.

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[1] Background information on BusinessNZ is attached to this letter as Appendix One.

This suggests that what is required is a clear medium to long term pathway appropriate to the New Zealand economy, environment, business and social conditions, but one that can be changed if actual international circumstances warrant it. Not a pathway based on expectations of international action whose impact on the domestic economy and environment changes as international expectations constantly evolve. BusinessNZ considers that the changes outlined in the amending Bill appropriately strikes this balance.

In particular, BusinessNZ is pleased that Government has heeded calls that it develop and implement a set of initiatives that:

- does not accelerate the cost trajectory already faced by business relative to their competitors. An escalating price would place our international competitiveness at risk while our trade competitors do not face a similar cost[2]. This very point was made well in a recent statement in the House on 13 June 2012 by the Hon Steven Joyce, in response to a question, where he said:

  > "What we are saying is that New Zealand's businesses that export should not have to face costs that other countries' businesses do not have to face. So when we are applying the emissions trading scheme we are being very careful to ensure that New Zealand's export industries……..It is not a subsidy; it is literally making sure that we are not putting burdens on our companies that other countries are not putting on theirs."

  [Sitting date: 13 June 2012, Volume 680, page 10. Text subject to correction]

- avoids unnecessarily burdening fuel and electricity consumers with higher costs at a time of extremely difficult economic circumstances (heightening the risk of fuel poverty);

- reflects New Zealand's contribution to global emissions and our specific emissions problem (rather than simply copying other scheme's design features that are aimed at solving their emissions problems, not New Zealand's);

- is well balanced between the needs of taxpayers, businesses, and consumers;

- avoids a knee-jerk, short-term fix based on current low carbon prices. Carbon prices will not always be so low, and the fundamentals of the 2008 scheme, designed to be flexible enough to reveal changing international carbon market conditions, remain in place;

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[2] Under the Australian carbon tax scheme, the extent of compensation (via free units, grants and tax rebates) allocated means that its impact on businesses and consumers is limited despite the higher starting price of $AUD23t/$CO_2$. There is also much talk of other Asian schemes (e.g. China, Korea, Singapore), but little tangible action. The Chinese schemes are subject to significant implementation uncertainty while a decision on Singapore's scheme has been delayed. The Korean scheme, if implemented, provides for 95% of allowances to be freely allocated in the first three years, with many trade-exposed businesses to receive 100%.

- removes the threat of constant pre-scheduled tinkering. Pre-scheduled reviews risk entrenching policy uncertainty and make the scheme unpredictable. Markets do not respond well to unpredictability. Indeed on-going speculation about changes around the reviews creates speculative shifts in value between market participants, at an economic cost; and

- avoids the regulatory uncertainty that would have been created by the previously proposed (but since discarded) use of enabling powers for significant elements of the scheme's design.

<u>A Comment on the Proposal not to Limit the Inflow of International Units</u>

Much criticism has been levelled at the policy decision not to limit the import of international units. BusinessNZ considers that the decision not to place a quantitative limit on the import of international unit is appropriate. A limit on units:

- simply because other schemes have such limits fails to recognise what is best for New Zealand given its unique economic and emissions circumstances. Looking to what others may or may not be doing is interesting, but no more, when determining what is the appropriate level of domestic economic burden;

- is based on bad economics, as it is based on the suggestions that:

  a. it is somehow better for New Zealander's to buy more expensive domestic goods (in this case New Zealand Units) for the sake of domestic jobs and investment. This is akin to saying that despite being able to import cheaper cars, consumers should be forced to buy locally made cars despite the fact that they are more expensive; and

  b. the flow of funds offshore can be damaging to the economy. To provide some perspective, Statistics New Zealand recorded the imports of vehicles, parts, and accessories for the 12 months ending April 2012 as being valued at $4,621 million. The net import of units for the same period of 5.8 million units at say $7t/$CO_2$ equates to $40.6 million, or <u>**0.9%**</u> of vehicles parts and accessories value.

- was not recommended by the 2011 ETS Review Panel, on the basis that to limit the free flow of units would contravene the principle, established in the 2008 scheme design, of least cost compliance; and

- has not been shown to deliver a positive net economic benefit, where the economic costs arising from a limit are shown to be outweighed by the economic and environmental benefits arising from greater afforestation.

A Comment on the Proposal to Auction New Zealand Units

BusinessNZ supports the proposal to introduce auctions on the basis that there is sufficient international market uncertainty to justify action. However, BusinessNZ notes the Minister's comments that:

> "43. The proposals were not designed to increase the price of NZUs within the ETS. My strong view is that this price should continue to reflect the international price."
>
> and
>
> "46. On balance, I propose that a new power to place a restriction on the proportion of international units an ETS participant can surrender is not introduced in the context of auctioning. This will mean that:
>
> - the ETS remains open to international markets;
> - the new power to introduce auctioning within an overall cap in the number of NZUs auctioned or allocation cannot by itself be used to influence ETS prices; and
> - the NZU price will continue to reflect the international price.
>
> 47. This is consistent with Cabinet's agreed objective for the ETS to 'deliver emission reductions in the most cost effective manner'."[3]

In light of these comments, BusinessNZ considers that their flavour should be woven into the matters relating to the powers of the Minister to sell units by auction. More specifically, BusinessNZ proposes that a new (p)(i) be inserted into section 30G(1), being:

> (i) when designing the auction mechanism to be consistent with the objectives to minimise transaction costs and have it reflect the international price

Looking Forward

While some may perceive the Government's proposed amendments to the NZETS to be a serious weakening of the scheme and the incentives it provides, it is important to keep the scheme, and what it can achieve, in perspective. Key to this are that:

- it is extremely unlikely that any other jurisdiction will ever develop and implement an 'all gases, all sectors' emissions trading scheme; and
- emissions trading schemes are only a small part of the overall sustainability story. For example:
  a. the broader sustainability story is as much, if not more about water footprints, animal husbandry, packaging, etc as it is about emissions trading; and

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[3] Minister for Climate Change Issues, Cabinet Paper entitled 'Emissions Trading Scheme Review 2012 – final decisions on amendments to the Climate Change Response Act 2002'.

b. emission reduction is more about ‘permission’ to participate in global supply chains and their requirements than emissions trading schemes.

This suggests to BusinessNZ that policy-makers and others need to move on from their fixation on the NZETS as the sole mechanism for delivering emission reductions and look to developing a broader set of complementary measures to sit alongside the NZETS.

<u>Comments on the Shortened Select Committee Process</u>

Finally, BusinessNZ notes the criticism of the shortened select committee consideration. BusinessNZ appreciates the frustration that has been expressed (though we note that such a practice is by no means an unusual occurrence). However, in light of the need for clear and early signals to business that the changes will be in place for implementation on 1 January 2013, and the fact that the arguments for and against the proposals are well-rehearsed, BusinessNZ considers that these factors out-weigh the need for a longer select committee process.

Summary

To avoid the risk of dampening investment and consumption, a long term perspective needs to be brought to these issues. BusinessNZ considers that what is set out in the amending Bill provides for a more certain policy pathway but with the flexibility for this pathway to be shortened should evidence of greater international action warrant it. This will provide greater certainty, and confidence in which businesses and consumers can act and enable the NZETS to function as it is intended.

To do otherwise would be inconsistent with previous commitments not to place a burden on business that is disproportionate to the costs faced by our trading partners or excessive at a time of global economic weakness.

BusinessNZ would welcome the opportunity to appear before the Select Committee to present its views in person.

Yours sincerely

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BusinessNZ

APPENDIX ONE: ABOUT BUSINESSNZ

Encompassing four regional business organisations (Employers' & Manufacturers' Association (Northern), Employers' Chamber of Commerce Central, Canterbury Employers' Chamber of Commerce, and the Otago-Southland Employers' Association), BusinessNZ is New Zealand's largest business advocacy body. Together with its 80 strong Major Companies Group, and the 70-member Affiliated Industries Group (AIG), which comprises most of New Zealand's national industry associations, BusinessNZ is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.

In addition to advocacy on behalf of enterprise, BusinessNZ contributes to Governmental and tripartite working parties and international bodies including the ILO, the International Organisation of Employers and the Business and Industry Advisory Council to the OECD.

BusinessNZ's key goal is the implementation of policies that would see New Zealand retain a first world national income and regain a place in the top ten of the OECD (a high comparative OECD growth ranking is the most robust indicator of a country's ability to deliver quality health, education, superannuation and other social services). It is widely acknowledged that consistent, sustainable growth well in excess of 4% per capita per year would be required to achieve this goal in the medium term.