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ETS Review Consultation
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Updating the New Zealand Emissions Trading Scheme

BusinessNZ is pleased to have the opportunity to provide a submission to the Ministry for the Environment on its consultation document entitled 'Updating the New Zealand Emissions Trading Scheme: A Consultation Document', dated April 2012.¹

Introduction

BusinessNZ welcomes the Government consultation document outlining its proposed changes to the New Zealand Emissions Trading Scheme (the 'NZETS', or 'the scheme'). There are clearly some changes that need to be made to the scheme to correct the premature roll-off of the two moderating features, to reflect developments in the international climate change negotiations and the 2011 ETS Review Panel's recommendations.²

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.³ Caution is required against 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.

¹ Background information on BusinessNZ is attached in Appendix One.

² This submission predominantly focuses on the non-forestry and agricultural aspects of the Government's proposals. However, having said that, given the complex interactions and incentives created by the operation of the scheme, it is recognised that the detail of this submission will potentially have implications across the entire scheme.

³ This is often referred to as policy making in a highly uncertain environment. In regulatory economics, the appropriate response to this is generally known as the 'value option of waiting'. In other words, in addressing complex policy issues it is often better to wait or make carefully assessed changes until more certain information comes to hand than make decisions whose interventions cause market changes that are uncertain but irreversible. Waiting enables policy makers, in light of more subsequent information, to observe if the initial response is inadequate (in other words, the expected benefits do not materialise). If this is the case, then the original intervention can be intensified or additional measures deployed. The practical effect of waiting is to set a higher cost-benefit threshold for interventions. This applies equally to interventions that provide the flexibility to take future action.

This suggests that what is required is a clear medium to long term pathway appropriate to the New Zealand economy, environment and business 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. This is currently the case.

On the face of it, the proposed changes (particularly those concerning the supply of units) are fairly orthodox and look to bring the design of the NZETS more into line with those of the EUETS and Australia. However, not only are they new (having not been recommended by the ETS Review Panel), but they also reflect a substantial shift in approach for New Zealand away from a responsibility target and a least-cost objective towards a more managed market targeted at delivering greater domestic action but with highly uncertain environmental benefits.

BusinessNZ can appreciate the desire for Government to have a scheme that provides it with maximum flexibility to deliver the outcomes it seeks in light of the on-going international uncertainty. However, this belies the very nature of the complex and intricate web of incentives set in play by the implementation of a trading mechanism. A short-term fix with the threat of constant tinkering risks making the scheme unpredictable. Markets do not respond well to unpredictability.

The regulatory uncertainty created by the use of enabling powers for such significant elements of scheme design, and the additional economic cost that will inevitably come with it, suggests that their further consideration should be deferred until a more compelling case for their use can be made. A key focus of this submission is, therefore, on the extent to which the changes proposed for business flexibility sought by Government is warranted, or even necessary, at this time.

Summary of Recommendations

BusinessNZ recommends that the Government:

1. with respect to the two moderating features:
 - a. align their removal with the entry into force of the new international climate change agreement in 2020:
 - i. for the 1:2 progressive obligation phase: this out at the following rates - 67% = 2013, 2014 & 2015, 83% = 2016, 2017, 2018 & 2019, 100% = 2020; and
 - ii. for the price cap: keep this fixed at \$25/t/CO₂ through to the end of 2019; and
 - b. explicitly provide for the earlier removal of these moderating features to make the NZETS more stringent on the attainment of

some suitable metrics based around the extent of global emissions covered by a carbon pricing in other jurisdictions (at an economy or sectoral level) and comparable effort, in terms of GDP per capita or some other appropriate metric;

2. in light of the on-going domestic and global economic weakness, consider a range of other options that would ameliorate the current impact of the NZETS until such time as a global trading market develops, such as:

- a. providing (as in Australia) for deferral of the 1.3% allocation phase-out if less than an agreed percentage of sectoral competitors have introduced comparable carbon restraints;
- b. implementation of a value-added criterion to the allocation eligibility criteria (to enhance consistency with Australian business eligibility conditions);
- c. establishment of a new, third allocation threshold (for example, 40% allocation at 400t/CO₂-e per million dollars revenue or the value-added criterion) to better protect medium-sized businesses;
- d. including the use of liquid fossil fuels and fugitive emissions in calculating emissions intensity and allocative baselines for those who qualify as emissions intensive, trade-exposed; and
- e. considering, consistent with Government objectives in both the climate change and technology innovation areas, the development of an offset crediting mechanism targeted specifically at the introduction of low carbon technologies in order to contribute towards the development of a more vibrant technology sector;

3. with respect to the new, proposed enabling powers:

- a. there is no justification for the use of the enabling powers, as proposed;
- b. the use of broad-sweeping regulatory powers in the context of the NZETS is poor regulatory practice that is likely to create unpredictability and will come at an economic cost. Such powers, if proposed in the context of the financial or other commodity trading markets, would be seen as capricious;
- c. implement the power to use auctions, subject to:
 - i. it being used solely as a safety valve in the absence of a functioning international carbon market, and is disconnected from, and unrelated to, the other two proposed mechanisms (the domestic cap and import limits); and
 - ii. there being clarity around the use of auction revenue in the scenario where New Zealand has no internationally legally binding emission reduction obligation; and

- d. set aside further consideration of the implementation of a domestic cap and import limits until analysis is provided about their use and impact (both individually and combined on the scheme and the wider economy) that clearly demonstrates their use to be both warranted and necessary, and providing a net public benefit; and
4. with respect to other matters:
- a. in order to guide future policy development:
 - i. publish the analysis of New Zealand's effort compared to the effort being undertaken by a range of other jurisdictions (particularly New Zealand's trade competitors) in order to determine how New Zealand's effort stacks-up against a range of comparators; and
 - ii. undertake a quantitative assessment of the costs and benefits arising from *each* proposal in order to be assured that there are net public benefits; and
 - b. provide the Government with the power to sell any excess units it might hold in order to help it achieve its desired emission reduction target, subject to a conversation with stakeholders about the use to which the revenue is put.

Setting the Scene: Some Context

Before getting into the substance of the submission, it is worthwhile first reflecting on the broad agreement to the fact that there is a public policy rationale to take action to address the risks of climate change. That is, there is a problem to be addressed. BusinessNZ agrees that New Zealand needs to be seen internationally to take some action to meet its international commitments, as well as for 'brand' and trade reasons, and to a lesser extent, to give it credibility in international negotiations. BusinessNZ also considers that it is important to have a policy mechanism that addresses the 'right' problems and suits the economic circumstances of New Zealand and New Zealand businesses.

These cornerstone propositions have given direction to BusinessNZ advocacy, and led it to conclude, some time ago, that an emissions trading scheme is likely to be the best long-term policy instrument. But BusinessNZ considers that the NZETS will only be the best domestic policy solution *if* there are multiple jurisdictions pricing carbon into their export sectors and a deep and liquid global carbon market evolves.

The fact that New Zealand has an operational scheme has provided its businesses and consumers some clarity about its immediate effects. But continued careful judgement is required about where the costs and benefits of the scheme will fall and what their impact will be. For some businesses, new market opportunities have emerged or beckon. However, for most businesses, concerns remain about the impact of climate change policies on their incentives to invest and grow and the opportunities foregone.

The existence of a liquid global carbon market in the near to medium term seems increasingly unlikely. This is mirrored in glacial progress toward a global climate change agreement with binding emission reduction targets for all major emitters. Durban gave rise to some hope, but a new global arrangement remains some way off. It is also important not to read too much into what progress that has been made – the content of a new international arrangement is unknown and a new agreement could entrench New Zealand's competitive disadvantage, not alleviate it.

In the absence of action by others to price carbon in a transparent way and in ways not offset by contradictory subsidy policies, assumptions made even as recently as a year ago concerning the transitory nature of competitive impacts on what are otherwise competitive, trade-exposed businesses, the speed of action by our trade-competitors to price carbon, and the ability to remove the moderating features no longer hold. Australia is New Zealand's largest market for exports, with more than one-fifth of all exports but rounding out the top five markets are China (to which exports were more than three times higher in 2011 than in 2006), the United States, Japan and Korea. None of these have priced carbon yet and where they are planned (Australia, Korea and China), its future or comparable impact is uncertain.

In this context, it is important that any moves to increase the stringency of the emissions trading scheme to be set within a clear objective, respond to a clear definition of the problem, and some strong evidence of a net public benefit. These are the foundations of sound policy making. BusinessNZ has some concerns in these areas.

The Importance of a Clear Objective for the NZETS

As outlined in the Cabinet paper, in November, 2010, the Cabinet agreed to a set of objectives for the 2011 emissions trading scheme review. These were that the emissions trading scheme should:

- "• help New Zealand to deliver its 'fair share' of international action to reduce emissions, including meeting any international obligations;
- deliver emission reductions in the most cost effective manner; and
- support efforts to maximise the long term economic resilience of the New Zealand economy at least cost."⁴

While these may have been useful to the review panel in the context of the review, contrary to the view of the former Minister, BusinessNZ does not consider these to be appropriate as an assessment tool for the day-to-day functioning of a fundamental piece of economic architecture such as the emissions trading scheme. When making an assessment of the efficiency of the scheme, how does one, for example, easily factor in delivery of a "fair share", or "resilience"?

⁴ Minister for Climate Change Issues Cabinet Paper entitled 'Emissions Trading Scheme Review 2012 – proposed amendments to the Climate Change Response Act 2002, page 4, paragraph 18.

One need only look at the objectives, sub-objectives and criteria used in the regulatory impact analysis to see how this has played out in practice (the following table, replicated below from Annex 1 of the Regulatory Impact Statement, pages 44-45, is informative in this regard).⁵

Top level objectives	1. Help New Zealand to deliver its 'fair share' of international action to reduce emissions, including meeting any international obligations		2. Deliver emission reductions in the most cost-effective manner					3. Support efforts to maximise the long-term resilience of the New Zealand economy at least cost			
Sub-objectives	1A. Meet international obligations	1B. Achieve a level of emissions consistent with New Zealand's 'fair share'	2A. Minimise negative economic impacts in the short term	2B. Maintain international competitiveness of New Zealand businesses in the short term	2C. Ensure administrative efficiency and effectiveness	2D. Minimise fiscal costs	2E. Ensure efficiency of carbon market	3A. Maximise long term economic resilience	3B. Maximise equity between sectors and groups	3C. Ensure the Crown-iwi relationship under the Treaty of Waitangi is appropriately reflected in ETS legislation, regulation, policy and implementation	3D. Minimise negative environmental impacts and promote positive environmental impacts
Assessment criteria	a) Facilitate progress of international efforts to address climate change	a) Contribute to meeting New Zealand's 'fair share' by 2020	a) Minimise short term negative impacts on economic welfare (e.g. GDP, National Disposable Income, etc)	a) Minimise carbon cost differentials between New Zealand's trade exposed businesses and its trading competitors and partners	a) Minimise administrative and implementation costs to Government	a) Minimise fiscal costs	a) Maximise market liquidity	a) Minimise negative economic impacts in the long term	a) Maximise equity between sectors of the economy	a) Appropriately reflect the Crown's responsibilities as a Treaty partner [withheld]	a) Minimise negative (wider) environmental impacts
	b) Contribute to meeting New Zealand's existing international obligations	b) Provide incentives for businesses to adopt existing emission abatement opportunities	b) Minimise costs to non-trade exposed businesses	b) Minimise risks of trade sanctions or harm to New Zealand's clean and green reputation for New Zealand's exporters	b) Minimise compliance costs to ETS participants	b) Maximise fiscal savings	b) Maximise market transparency	b) Maintain international competitiveness of New Zealand's businesses in the long term	b) Maximise socio-economic equity, e.g. between high- and low-income households	b) Support the development by Māori of their natural resources in ways that contribute to the development of the Māori economy, and which are consistent with their environmental values	b) Maximise positive (wider) environmental impacts
	c) Enhance New Zealand's international credibility to influence the outcome of international climate change negotiations	c) Provide incentives for consumers to buy low-emission products	c) Minimise competition distortions within and between sectors of the New Zealand economy		c) Minimise transaction costs to ETS participants buying or selling emission units		c) Facilitate future links with overseas emissions trading schemes	c) Provide incentives for the development of new emission abatement opportunities at least cost and businesses' ability to meet future demand for low-carbon products	c) Promote inter-temporal equity, namely equity between present generation and future generations		c) Ensure environmental integrity of international emission units surrendered in the ETS
		d) Contribute to meeting New Zealand's 2050 domestic emission reduction target			d) Promote understanding of the ETS				d) Ensure appropriate risk-sharing between emitters and Government/taxpayers		

⁵ This table is replicated purely for demonstrative purposes. Should the reader wish to access a more visually satisfactory view then they should refer to Annex 1 of the Regulatory Impact Statement.

In these circumstances, by necessity, judgement begins to predominate over evidence-based analysis and what analysis there is becomes overly confused and unnecessarily complicated. The choice of solution becomes more art and politics than science and analytics.

In BusinessNZ's view, the objective of the emissions trading scheme should be simple and concise:

To comply with New Zealand's international obligations to reduce global greenhouse gas emissions in the most efficient manner.

"In the most efficient manner" speaks to the implementation of the emissions trading scheme in the least cost way, the allocation of resources to their highest value use and to the pursuit of innovation and investment. Such an approach is more likely to simplify the analysis and make it more amenable to a cost benefit analysis, not to mention assisting in determining the right solutions. Other judgements are more appropriately left to politics.

Defining the Problem(s) to be Addressed

It is important to have a well-defined problem in order to ensure that the right set of solutions is being considered. While many of the problems described in the Regulatory Impact Statement are fairly self-evident and speak to the need to keep the scheme fit-for-purpose (such as the introduction of forestry offsetting), in other cases it is difficult to draw a straight line between the description of the problem and the recommended solution. The description of the problem relating to the phase-out of the moderating features is a case in point. The Regulatory Impact Statement describes this as:

"Some stakeholders expressed concerns that the impact of the ETS on household and business costs would increase significantly in 2013 following the expiry of the one-for-two surrender obligation."⁶

While a significant increase in costs would be an issue, this describes the symptom, rather than the problem. BusinessNZ considers that the appropriate characterisation of the problem is the risk to the competitiveness of New Zealand's firms. Similarly, the 'problem' attributed to the need to introduce auctions – an excessive amount of emission reductions when the number of overseas units purchased and surrendered is taken into account – is also a symptom and not a problem.

Other areas fair even less well. Proposals such as those to place a domestic cap on New Zealand emissions, and to limit the amount of imported units that can be used for compliance purposes are solutions looking for a problem. No clear definition of the market failure (in this case, the failure of the trading scheme to operate in an efficient manner) is provided, either in the consultation document, the Cabinet paper or the Regulatory Impact Statement.

⁶ Ministry for the Environment Regulatory Impact Statement entitled 'ETS Review 2011: Proposed amendments to the Climate Change Response Act 2002 – Part 1, page 24, paragraph 85.

Finally, BusinessNZ notes that the Cabinet paper says:

“In addition to the [withheld] impacts outlined above, the proposal to introduce auctioning would have a positive impact on the Government’s net debt position. Auctioning provides the Government with a financial asset, cash, at the point of auction rather than carbon units which are an intangible asset.”⁷

BusinessNZ wonders about the extent to which the real problems being addressed by the proposals relate to a desire to provide cashflow, insure the Crown against any fiscal risk associated with market developments at a time it is under fiscal pressure or indeed the perception of the current low price of carbon.

Evidence of a Net Public Benefit

To determine a course of action with any confidence requires a cost benefit analysis that demonstrates a net public benefit (in other words, an increase in New Zealand’s economic welfare). Indeed, good public policy demands justification of the proposals in terms of its net public benefit to New Zealand-inc. BusinessNZ continues to maintain that Government interventions should not be undertaken that cannot be demonstrated to be in New Zealand’s best economic interest.

Despite having been active in the area of domestic climate change policy since it was first discussed, BusinessNZ has yet to see an honest attempt at assessing, against the counterfactual (in this case the current Climate Change Response Act 2002), where the net benefit lies. Ultimately, an effort must be made to demonstrate that the benefits of a more stringent scheme outweigh the costs of making it so. For example, retention of the 1:2 progressive obligation is likely to yield a net public benefit and importantly this is also likely to extend beyond 2015.⁸ If such analysis has been undertaken, it has not been released.

Given the fairly well prescribed nature of the proposals in this case, BusinessNZ was hopeful that this would be the first time such analysis was provided for scrutiny. At a minimum, in order to be assured of the underlying quality of the proposals, BusinessNZ expected the regulatory impact statement to have included at least a high-level cost-benefit analysis.

BusinessNZ is concerned about the complete absence of financial information from the discussion document and what qualitative information is provided is extremely ‘soft’. This is, after all, a market whose impact is intrinsically dependent upon the demand and supply of units and their price. BusinessNZ

⁷ Minister for Climate Change Issues Cabinet paper, *ibid*, page 23, paragraph 168.

⁸ This view is based on the orthodox treatment of wealth transfers between taxpayers and consumers (to exclude them) and the likely positive impact on the competitiveness of New Zealand businesses (relative to the counterfactual of the removal of the progressive obligation on 31 December, 2012) from its retention until such time as New Zealand’s trade competitors face a similar cost.

presumes that this has something to do with the overall complexity of the assessment criteria, as outlined above.

While BusinessNZ hopes that a full cost-benefit analysis will be undertaken before final decisions are taken, greater effort to provide a quantitative assessment of the costs and benefits of the proposals would have helped submitters form their view.

Dealing with Incomplete or Inadequate Information

Finally, before moving on to a discussion of the specific proposals, it is worthwhile noting that it is extremely difficult to make informed judgements on the proposals put forward when not all of the information pieces of the puzzle are present.

Paragraph 37 of the Cabinet paper is a case in point. This paragraph notes:

“In particular, it is important that the ETS is able to deliver whatever level of international emissions reduction effort New Zealand may wish to demonstrate in this period; but that it does not impose costs and reductions in economic welfare that are over and above *this level*.”⁹ (emphasis added)

In the absence of knowing what “this level” that is referred to at the end of this paragraph actually is, BusinessNZ considers it extremely difficult to assess whether or not the costs being imposed by the proposals are, in fact, over it.

Flexibility is a desirable attribute. However, not being able to place limits around what flexibility might entail is highly problematic in the context of a consultation document. The key pieces of missing information in this regard relate to:

1. the emission reduction target New Zealand is willing to commit to (as this relates to the proposal to impose a domestic emissions reduction cap);
2. whether New Zealand is going to commit to a second Kyoto Protocol commitment period, and if so for which length (as this relates to the nature of the relationship between the NZETS and the international rules being used, and how closely aligned they are); and
3. a specific proposal to limit imports, for example, a 50% limit or a limit of some other level, higher or lower (as this relates to the domestic price of carbon, and the risk of price separation - between the New Zealand domestic unit [the ‘NZU’] and international units).

⁹ Minister for Climate Change Issues Cabinet paper, *ibid*, page 7, paragraph 37.

Instead, stakeholders are advised that:

“ A critical priority for a package of amendments to the ETS is to ensure that it can be tailored to deliver the level of effort Ministers wish New Zealand to demonstrate in this period.”¹⁰

BusinessNZ can appreciate the desire of the Government not to rush into these decisions, and (in the case of the first two items above) instead prefer to wait and see what other jurisdictions are doing (in order for it to be able to better understand the context within which it is operating, including where the balance of risk and benefits may lie). However, a completely different standard appears to be applied in the case of business and consumers, both of whom are essentially being asked to trust the Government to ‘get it right’ now ahead of final decisions on these and other factors being made or becoming clear. The Government will understand businesses reticence to do so in regard to the NZETS.

Much of the debate about the NZETS boils down to a debate about its stringency and the pace with which it is made more stringent. In light of this, and the desire to make the NZETS more flexible, BusinessNZ also expected some analysis of the comparative effort being made by New Zealand, relative to that of other jurisdictions (presumably in terms of GDP per capita, or some other such suitable metric). No such information is forthcoming. It is therefore difficult to judge the extent to which the NZETS, in becoming more expensive for business and consumers, retains New Zealand’s position ahead of the curve or not.

Finally, in light of the importance of the impact of the scheme on the Government’s finances, and of the prominence of the proposal to implement auctioning, BusinessNZ is surprised that the Government’s fiscal forecasts have not been released. This makes it difficult to assess policy maker’s assumptions about overall net positions and with respect to auctions, assumptions about revenue flows.

Assessing the Specific Proposals

BusinessNZ’s view of the proposals concerning the moderating features and the powers to implement auctioning, a domestic emissions cap and a limit on the import of units is conditioned by the contextual information set out above. This section sets out some more specific information on the proposals.

The Moderating Features

By making an early start compared to other countries on emissions trading, New Zealand export businesses (and those who compete with imports) have been placed in a vulnerable position – they now have to compete against companies overseas that in the most part do not pay any carbon charges. Allocating carbon credits is simply a way of reducing that vulnerability, and is

¹⁰ Op cit, page 7, paragraph 34.

in the best interests of all New Zealanders. Once other countries – specifically our trade-competitors – adopt emissions trading that vulnerability will cease.

But in the meantime the risk of carbon leakage, and therefore the need to protect vulnerable businesses, is often down-played with many instead preferring to focus on the opportunities that might arise from a more stringent carbon price.

While a balance between the costs and benefits of the NZETS needs to be carefully considered, BusinessNZ believes that the on-going risk of carbon leakage is real and will be heightened with the removal of the moderating features. Work done recently for the Ministry for the Environment highlights the reality of the risk of carbon leakage.¹¹ As noted above, the concern is that entrenched asymmetric environmental policies will reshape the pattern of international comparative advantages, incentivising New Zealand businesses to move from countries where environmental measures are stricter, to countries that are not subject to the same requirements.

BusinessNZ considers that the widespread failure of other countries to adopt carbon pricing (which gives rise to the risk of carbon leakage), combined with the absence of a deep and liquid carbon market (which means that businesses cannot efficiently manage their carbon price risks) creates unacceptable economic risks and extends the scheme's reach beyond a reasonable level of commitment.

Businesses – both emitters and those who see opportunities - want a long-term, predictable pathway which will enable them to invest with confidence. However, the continuation of the moderating features for only a further short-term period is unlikely to deliver this. Instead, it is likely to deliver on-going policy uncertainty.

The Government can rectify this now by 'fixing' the level of economic burden that New Zealand is willing to accept until the international environment has crystallised (for more on this point, see section below entitled 'A New Approach to ETS Policy Making').

Rather than extending the moderating features for only a further two years, through to the commencement of 2015 (which provides no long-term clarity at all), BusinessNZ considers that for the 1:2 progressive obligation should, *subject to international progress*, be phased out at a slower rate through to 2020. The price cap should also be retained for a similar timeframe, on a similar basis.¹² Extending policy settings beyond 2015 is crucial to provide

¹¹ See the Covec Ltd report entitled 'Impacts of the NZ ETS on Emissions Leakage' at <http://www.climatechange.govt.nz/emissions-trading-scheme/ets-review-2011/supporting-info/impacts-of-the-nzets-on-emissions-leakage.pdf>.

¹² Depending on assumptions about the price of carbon (based in turn on assumptions about the level of international demand and supply of units), the retention of a price cap will either be costless to the Government, or vital to protect the competitiveness of New Zealand businesses in the absence of concerted action by others.

business with greater predictability and vital to move beyond the stop-start nature of the debate that has typified the discussion since the scheme's inception.

The Use of Enabling Powers

The three elements of auctions, a domestic cap on emissions and the limit of imports of international units are central to the Government's desire to preserve for itself the maximum amount of flexibility possible. This flexibility is sought in order to address the high level of uncertainty associated with some of the scheme's key influencing factors. More specifically, the Government seeks greater flexibility over the level of overseas units being purchased, and the level of emission reductions the NZETS achieves.

Is Flexibility Needed to Address Uncertainty?

As noted above, there are some advantages to flexibility. In an uncertain future flexibility provides the option-holder with a range of potential responses. However, it is unclear whether these features are required, or if additional flexibility is required, whether these are the least cost means to deliver it.

In light of uncertainty about the international market, auctioning is positioned as a way of increasing domestic supply to reduce dependence on international units, with the restriction on imports to help ensure the purchase of international units is reduced.

BusinessNZ acknowledges the NZU supply gap post 2012, but BusinessNZ is unclear why access to the international market is a problem *now* when this supply situation has been known since the scheme's inception. The NZETS was explicitly designed around access to the international market to address it.

The unfettered access to international units has been a cornerstone of the New Zealand scheme since 2008 and is consistent with the treatment of New Zealand's emission reduction target as a 'responsibility' target that could be met by either domestic or international action. This indifference to emission reduction source is consistent with the scheme's 'least cost' compliance objective. It was widely recognised that New Zealand's emission profile - dominated by agricultural gases – results in a steeply rising abatement cost curve that would impose too high an economic cost for limited domestic environmental benefit.

As recently as July last year, the ETS Review Panel decided *not* to recommend a limit on international units saying:

"The Panel believes that while the intention of the ETS is to change behaviour, it should also allow for flexibility as to how participants meet their obligations. If participants can meet their obligations at lower cost by purchasing emission units from international markets then this should be

allowed. This is a key measure for mitigating against excessive short-term costs whilst also being consistent with an international framework.”¹³

and

“The Panel believes it is in New Zealand’s interests for the ETS to be as open as possible (that is, access to international carbon markets), as this will minimise the cost impact on the economy.”¹⁴

Somewhat ironically, such unfettered access is now being decried as giving rise to:

“ ... a serious danger of NZ essentially exporting capital for no good reason resulting in a loss of economic welfare.”¹⁵

and whose limit is needed to avoid:

... “excessive purchasing of international units and unnecessary offshore cash flows.”¹⁶

BusinessNZ considers these statements to be particularly good examples of fuzzy logic in support of the proposals, for the following reasons:

1. it appears to depend on the price of domestic units being equal to the price of international units. All things being equal, the domestic price of units being relatively illiquid, should trade at a slight discount to international units. In this scenario, the purchasers of units should be indifferent between the source, and a constraint on imports should make no difference. However, the price of domestic units has traded at a premium to the price of international units since about October last year with no sign of that premium being removed. This premium is caused by a so-called ‘flight to quality’ created by the policy induced regulatory uncertainty associated with the scheme’s design (the origins of the uncertainty being the rumours about the HFC-23 CERs being banned). Proposals such as those contained in the consultation document serve only to exacerbate regulatory uncertainty. BusinessNZ believes that there is little chance of the premium associated with domestic units being eliminated (especially if holders of NZUs continue to have price expectations that are higher than the market) and policy-makers should not attempt to redesign the NZETS as if the premium did not exist;

¹³ Ministry for the Environment report entitled ‘Doing New Zealand’s Fair Share, Emissions Trading Scheme Review 2011, Final Report, dated 30 June 2011, page 27, paragraph 63.

¹⁴ Op cit, page 77, paragraph 303.

¹⁵ Hon Tim Groser, speech to Climate Change Iwi Leaders Group National Hui, 11 April, 2012.

¹⁶ Ministry for the Environment Consultation Document entitled ‘Updating the New Zealand Emissions Trading Scheme: A Consultation Document, page 7.

2. the argument (somewhat unusually) appears to hark back to the days of 'Fortress New Zealand' in suggesting that it is good for the New Zealand economy to have import barriers to force New Zealanders to buy more expensive domestic goods (in this case, NZUs) for the sake of domestic jobs and investment. The "Think Big" projects were effectively designed to ensure that New Zealand didn't "export capital" to the Middle East. The proposition that import barriers were good for New Zealand was unequivocally untrue and simply reflected a misconception about where New Zealand's comparative competitive advantage lay (that is, generally not in heavy industry, but with some notable exceptions). Allowing businesses to buy more cheaper international units when domestic units are more expensive is *unequivocally* welfare enhancing; and
3. it is unclear that the measure relied upon by officials is actually intended to be used to support a case for an import ban. In this case, imports are subtracted from real Gross National Disposable Income ('GNDI', the welfare measure used by NZIER/Infometrics to model the impacts of the NZETS). To properly draw conclusions on welfare impacts policy-makers need to model the impacts of "exporting capital" against the impacts of preventing New Zealand businesses from having access to units that represent the marginal cost of abatement overseas (rather than a higher domestic price of carbon).

Flexibility is not Costless

It is also worthwhile noting that constant change, or even the threat of change, is not costless as the market will price risk in. The absence of more specific information about how these powers will be exercised once legislated for makes their precise impact hard to determine. The details are to be worked out only once the legislation has been changed to give the Government the power.

The NZETS will remain broadly benchmarked against the price of CERs. However, as many of the changes provide this (or future) Government's with options (such as around the level of the domestic cap and the level of import limits), even if not exercised, the uncertainty this regulatory flexibility creates will drive a risk premium into the market and inevitably, compliance buyers towards higher priced NZUs.

As noted above, this is already happening and comes at an economic cost in terms of avoided investment and jobs that are deferred but would have been economic (and therefore efficient) at the lower alternative price.

In light of the above, the proposals seem to be a short-term reaction driven by the current low price of carbon. But rather than needing 'fixing', this market response (to import cheap international units where they are cheaper than domestic units) instead reflects to BusinessNZ a well-functioning emissions trading market. Indeed, this trend can be expected to largely self-correct if concerns about the continued supply of international units come to pass. If the supply of international units tightens after 2015, the carbon price will rise

making domestic units more likely to contribute to meeting demand (subject, of course, to the view of the prevailing market price taken by the holders of NZUs).¹⁷ Other supply-related risks can be managed with the continued presence of a price cap and the progressive obligation.

In this context the problems posed, to which the enabling powers are put forward as solutions, largely evaporate. Auctioning is not required to provide flexibility – neither is a domestic cap or import limits – a well-functioning, flexible market mechanism already exists. Patience is required from policy makers right now, not tinkering.

It is also interesting to note that various scenarios regarding international circumstances were considered by policy makers under the Labour Government when initially designing the NZETS. They did not think the powers being sought by the Government now were necessary:

“If there was no successor agreement to Kyoto but an international market for emissions continues to operate, the government could continue to issue NZUs at an agreed level and establish domestic rules for the trading of international units meeting sufficient quality standards.”¹⁸

It is also informative to go back to the 2007 Labour Government Framework document on the issue of a domestic emissions cap. The Framework document openly described the NZETS as:

“ ... different from this classic type of cap-and-trade scheme in two ways:

- First, it operates within an overarching global agreement (the Kyoto Protocol). As the Protocol provides an international cap, *an additional cap for the NZ ETS is not required*. The global cap will lead to an international price of emissions that will set the price in the market of a NZ ETS.
- Secondly, under the Kyoto Protocol participants can earn project-based emission units by reducing emissions in developing countries that are signatories but do not have a binding cap. Participants can also earn removal units from eligible land use, land-use change and forestry activities in developed countries. *As a result, the cap on emissions for Annex B countries under the Kyoto Protocol does not act as an absolute limit, even at the international level; Annex I countries can collectively emit more than their aggregate cap if they earn units through the Clean Development Mechanism or the use of domestic forest carbon sinks.*¹⁹

(emphasis added)

¹⁷ The market view of the holders of surplus NZUs will be important in light of the incentives of foresters to bank their units to meet future liabilities. In light of this dynamic, it could always be in the interests of foresters to withhold their NZUs from the domestic market in an attempt to drive the price of NZUs above the price of international units. This could result in a persistent domestic unit price premium and the continued import of substantial levels on international units and, in turn, lead to continued calls for regulatory action to correct a ‘problem’ in the NZETS despite the fact that, as shown above, no problem exists.

¹⁸ Ministry for the Environment and Treasury document entitled ‘The Framework for a New Zealand Emissions Trading Scheme’, September 2007, page 56.

¹⁹ Op cit, page 48.

These arguments still seem to be as relevant today as they were in 2007 particularly given that the NZETS will still be relying on an international price of carbon, and units produced under the Clean Development Mechanism.

Pursuit of the 'Goldilocks' Scheme

This desire of policy makers to interfere in the otherwise efficient operation of the market seems targeted at delivering the 'goldilocks' scheme – neither too many nor too few international units, but just the right amount. Such a hope is a forlorn one, at best.

Having established a market mechanism in preference to a carbon tax, the focus of policy-makers must be on longer-term scheme stability and not short-term carbon prices. Having established a market mechanism as its primary policy tool of choice to deliver its carbon reduction objectives, policy-makers need to acknowledge that they cannot expect to be able to control, or predict its outcomes, and that to seek to do so will create further uncertainty and price volatility and establish a risky precedent of rapid political interference in the market.

Instead, the approach to changes to the NZETS, as a fundamental piece of economic architecture, should be akin to prospective changes to tax policy. In general these tend to be done infrequently (based on a clear argument, such as maintaining international competitiveness), well signalled (for example, in the course of an election campaign), worked-through in a deliberate and transparent manner (for example, the most recent Tax Working Group) and implemented with care.

BusinessNZ is unclear what it is specifically about the emissions trading scheme but amendments to it are almost uniformly undertaken in a rush, with short consultation periods and inadequate information. This current consultation is, unfortunately, no different. While BusinessNZ appreciates that in this case that there is a legislative deadline that needs to be addressed, this does not suggest to BusinessNZ that all of the proposals need to be compressed into that timeframe – rather only what needs to be fixed by that deadline.

In light of the risks outlined above, policy-makers should not be given prescribed opportunities to amend the NZETS. This would be like including a regular schedule of reviews in the Tax Act. It is BusinessNZ's repeated plea to policy-makers that they remove the review clause. As Parliament is sovereign and can review the NZETS at any time, a pre-scheduled set of reviews is not required, and speculation about changes around the reviews creates shifts in value between market participants, at an economic cost.

The Enabling Powers and Linking with Australia

It is fairly obvious that the proposed introduction of auctions, a domestic cap and a limit on imports is designed to align the NZETS with the Australian

scheme (albeit in a 'soft' way). These are all features of the Australian scheme. Only price alignment remains to be addressed but this is clearly facilitated by the timing of the proposed removal of the moderating features in 2015.

BusinessNZ recognises that even if the proposed enabling powers are not justified on their own merit on efficiency grounds, they may be on the basis of enabling alignment with the Australian scheme.

However, this is a conversation for some later time:

"I note that providing explicitly for an overall cap on the amount of NZUs issued will also provide flexibility to link with the Australian CPM from 2015, *should that prove desirable*."²⁰ (emphasis added)

BusinessNZ considers that the importance of linking – even in a 'soft' manner as embodied in the proposed changes – warranted a fuller consideration of these issues in the current consultation process. Some indication of the anticipated marginal net benefits of retaining this option should have been provided.²¹

In light of recent evidence of Australian businesses relocating to New Zealand to take advantage of our lower cost structures and more stable policy settings, BusinessNZ would need to be convinced that alignment of the NZETS in any form with Australia will not erode one of New Zealand's competitive 'wedges' (its lower carbon price). New Zealand needs to be certain before it erodes its scheme differences that it is doing the right thing for the right reasons.

Auctions as a Safety-Valve

As noted above, auctions are not considered necessary to provide compliance buyers with a choice of units particularly if the price of domestic units is expected to mirror the international price (with the choice being dictated by buyer transaction costs).

However, auctions could still have a role to play in the NZETS as a safety-valve in the absence of a functioning international market between 2012 and 2020. Given the economic difficulties being faced by Europe, and the glacial pace with which the international negotiations are progressing, it is not completely outside the bounds of reality that the international carbon market could yet collapse in on itself in light of the uncertainty.

²⁰ Minister for Climate Change Issues Cabinet paper, *ibid*, page 10, paragraph 56.

²¹ That is, how the marginal benefits of introducing these features for the purposes of linking with Australia outweigh the marginal costs to the New Zealand economy of doing so.

Again, this scenario was considered by officials in 2007, when the view was that:

“ ... if there was no successor agreement to Kyoto and no international market for emissions to which New Zealand wishes to link, the government could maintain the ETS by auctioning NZUs, and could use a price cap to mitigate the price risks associated with a domestic-only trading scheme. This would ensure that New Zealand participants in the NZ ETS continued to face a cost of emissions in their business decisions, and to reduce the price uncertainty they faced.²²

BusinessNZ considers that it would be prudent to have the legislative ability to implement auctions as a safety-valve should the above circumstances come to pass.

Other Solutions

Given that the enabling powers are not required, there could be a range of other options that could provide the flexibility to address the level of ambition achieved by the NZETS. If the concern really is that of over-achievement on New Zealand's international obligation, as set out in paragraph 52 of the Cabinet paper, then a simple and effective solution would be for the Government to allocate more units to business.

This would be appropriate in light of the on-going domestic and global economic weakness, and would ameliorate the current impact of the NZETS until such time as a global trading market develops. Such options to consider would be:

1. providing (as in Australia) for deferral of the 1.3% allocation phase-out. For example, the Australian scheme provides for the possibility of the phase-out for highly emissions-intensive businesses pausing at 90% and 60% (having commenced at 94.5% and 65%) if less than 70% of competitors in their sector have introduced comparable carbon restraints;²³ and/or
2. implementation of a value-added criterion to the allocation eligibility criteria (to enhance consistency with Australian business eligibility conditions); and/or
3. including the use of liquid fossil fuels and fugitive emissions in calculating emissions intensity and allocative baselines for those who qualify as emissions intensive, trade-exposed.

The ETS Review Panel considered many of these issues and suggested that the Government explore a wider range of issues relating to allocation settings

²² Ministry for the Environment and Treasury Framework document, *ibid*, page 56, section 4.13.1.

²³ The phase out of free allocation in the Australian scheme is on a diminishing value, rather than on a straight-line basis, and the possible halt at 90% and 60% is subject to a recommendation from the Productivity Commission (see section 156(3) of the Clean Energy Act, 2011).

which have been raised by stakeholders. More specifically, it recommended that:

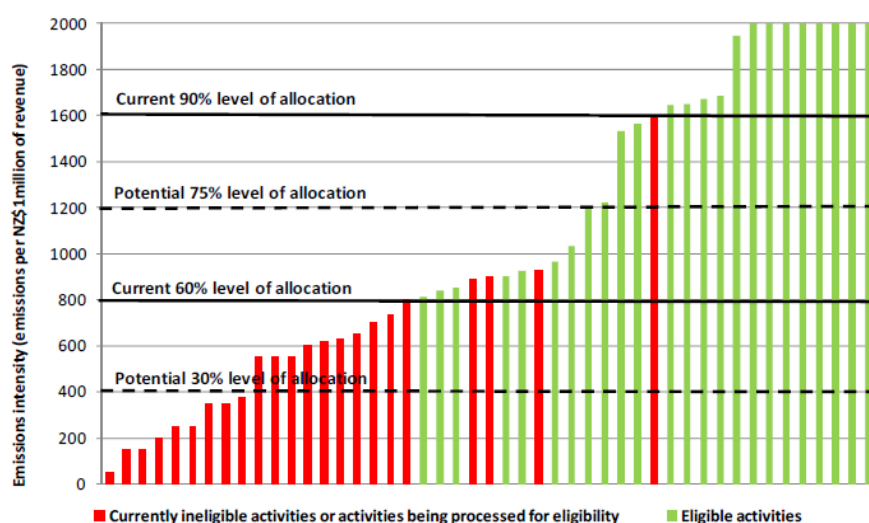
“The Government examine further the potential inclusion of additional eligible emission sources for determining eligibility and allocative baselines under the Act.”²⁴

To date the Government has shown no appetite to do this, and BusinessNZ considers that now would be an appropriate time.

Establishment of a new, third allocation threshold (for example, 40% allocation at 400t/CO₂-e per million dollars revenue or a value-added criterion) to protect medium-sized businesses also merits further consideration. Of the 141 firms who got allocations for the six months ended 31 December, 2010, 87 (or 62%) of them were hothouse growers. This suggests the presence of an ‘eligibility hole’ between the biggest firms (with food processing a notable exception) and the very smallest (in the 2010 half year, one business was allocated 30 units).

This issue was considered by the ETS Review Panel with its report (page 37) containing the following graph.

Figure 3.1: Industrial activities that may be eligible under alternative potential thresholds



Source: Ministry for the Environment.

The Panel concluded that on the information available to it, the costs of a lower threshold would outweigh the benefits of doing so. It is possible that administrative costs will increase, but the majority of such costs are likely to be one-off (in terms of determining eligibility) as the on-going administrative costs of administering a small number of additional eligible activities would be expected to be marginal. It is also possible that transaction costs for smaller businesses will rise.

²⁴ Ministry for the Environment ETS Review Panel Report, *ibid*, page 40, recommendation 3.11.

However, BusinessNZ has two observations on this point:

1. it is unclear how many small businesses would be eligible at a new lower threshold (BusinessNZ thinks it is fairly safe to say that the fact that hot-house growers are eligible came as a surprise to many, so it is unclear that this sort of eligibility pattern would be replicated); and
2. businesses have the option to determine whether or not the costs associated with participating in an eligibility process and then the associated on-going reporting and compliance costs are going to outweigh the benefits to them of participating. Participation is not mandatory with those who are most likely to benefit being the most likely to participate (in other words, those who are most in need of assistance will self-select into the scheme).

If the problem being addressed really is that of over-achievement on New Zealand's international obligation, then BusinessNZ is unsure why the option of using the excess units towards supporting an improvement in the uptake of low carbon supporting 'clean-technology' has not been considered.

The design of the NZETS is intended to fully incentivise participants to achieve emission reductions below business-as-usual. However, as long ago as the 2007 'Framework' document, policy-makers recognised that "an ETS does not incentivise all activities that reduce emissions", and that while "...the design of the ETS may not be sufficiently detailed to capture the activity" it was also considered that "an ETS framework can be augmented by the use of offsets."²⁵

At the moment, the use of the offset credits mechanism is carefully prescribed due to the difficulty associated with the design of an offset mechanism with an all sectors, all gases scheme. However, having said that, BusinessNZ considers that the more effective use of an offset credits mechanism would help contribute towards the development of a more vibrant technology sector, targeted specifically at the introduction of low carbon technologies. Trading in offset credits can also help encourage (that is, monetise) emission reduction efforts from sectors that are not as well suited to the trading scheme. This would align well with Government objectives in both the climate change and technology innovation areas.

However, two particular features would need to change to deliver a more effective offset credit mechanism:

1. the expansion of the mechanism to include both NZETS participants and non-participants; and
2. the ability for NZETS participants to invest in technology outside of their core sector for which units would not otherwise be able to be received (for

²⁵ The Ministry for the Environment and Treasury Framework document, *ibid*, page 48, section 4.9.1.

example, an electricity generator or a steel maker investing in bio-sequestration would not currently receive credits for that investment).

Therefore, BusinessNZ recommends that the Government amend the Climate Change Response Act 2002 ('the Act') to allow for either a downward adjustment of liability for a participant where emissions are not actually released into the atmosphere or the ability of non-participants to earn emission units for each tonne of emissions that is avoided.

Finally, BusinessNZ questions why the option set out in paragraph 53 of the Cabinet paper – to provide for the Government to sell any surplus units on the international market – is not considered in more detail before being dismissed. While BusinessNZ can appreciate the Government's preference for cash instead of units, BusinessNZ considers the sale option to have merit and should be pursued further. The market risk the Government might face is no greater than the risk being faced by compliance buyers - the Government will be selling into the market that businesses will be buying out of.²⁶ If the Government is seeking flexibility, then this (the ability to sell excess units) would be an appropriate option for it to hold.

Should this option be pursued in preference of a revamped offset crediting mechanism, the revenue gathered from the sale of surplus units could be used to underpin the use of complementary measures. An example of this could be a refocused Energy Efficiency and Conservation Authority ('EECA') as outlined by the Green Growth Advisory Group (the 'GGAG'). The GGAG suggested that EECA:

“ ... could substantially increase its engagement with smaller New Zealand businesses given the importance of energy efficiency in reducing GHG emissions intensity and in the greening of growth. The Advisory Group believes EECA could take on an expanded role with a focus on GHG emissions as well as energy, and with an orientation towards the information needs of SMEs. We see great merit in giving one government agency a clear mandate of support for such businesses as they tackle the challenges and opportunities implicit in green growth. A refocused agency, working with NZTE and MSI, and also regional partners, could become a highly effective enabler in New Zealand's quest for GHG emission reduction over the next 20 years and for higher economic growth.²⁷

Implementation of the New Mechanisms – Individually or Combined?

Should the Government continue to see merit in the use of auctions, a domestic cap and a limit on imports, BusinessNZ considers that how they are implemented will be extremely important. Additional clarity is sought as to

²⁶ In any case, as the NZETS is to remain benchmarked against the international (that is, the EUETS) price, the Government should be indifferent between cash from auctioning and selling surplus units as the price of the two options should be broadly similar (though auctioning is likely to be administratively more costly). In other words, a low international price of carbon will be reflected in low auction prices.

²⁷ The Report of the Green Growth Advisory Group entitled 'Greening New Zealand's Growth', dated December 2011, page 29, paragraph 4.14.

whether the intention is to have three mechanisms exercised separately where the use of the particular power is appropriate, or bundled in some fashion.

In the consultation document, they are presented as a power to auction within a domestic cap, and a separate power to limit imports. However, in the Cabinet minute, both the domestic cap and the limit on imports seem to be presented as factors to be considered as a part of a decision to auction (and therefore not separate enabling powers, and indeed, as factors that can be varied without reference to primary legislation). Additional confusion arises regarding the relationship between the consultation document, that states that the Government:

"intends to *introduce a mechanism* that would allow the Minister for Climate Change Issues to place a restriction on the proportion of international units an ETS participant can surrender "²⁸ (emphasis added)

and the powers that already exist under section 30G of the Act. This section provides the authority for regulations to be made for a wide range of purposes, including:

- "(b) prescribing matters, including (but not limited to) limitations, restrictions, conditions, exemptions, requirements, or prohibitions, in respect of—
 - (i) the transfer of units, including (but not limited to)—
 - (A) the transfer of units from an account holder's holding account to an account in an overseas registry:
 - (B) the transfer of units within the unit register:
 - (C) the transfer of units from an overseas registry:
 - (D) prohibitions on the transfer of units for the purposes of holding those units in an account in the Registry:
 - (ii) the opening or closing of holding accounts:
- (c) prescribing matters in respect of the holding, surrender, conversion, and cancellation of units, including (but not limited to) limitations, restrictions, conditions, exemptions, requirements, procedures, or thresholds:"

This section was relied upon to provide the regulation making power to ban CERs from HFC-23 and N₂O industrial gas destruction projects. It would appear from this section that if the Government intends to give itself the power to auction and wants to implement a cap on imports as a part of that (as implied in the way the Cabinet minute is written), the Government would first need to write regulations to do so under section 30G or risk being ultra vires.

Given the magnitude of exercising the power to limit units in the way contemplated, it is possible that policy-makers may not wish to rely on this section but rather expressly provide for the power to limit imports. Greater clarity around these issues would be helpful.

²⁸ Ministry for the Environment Consultation Document, *ibid*, page 7.

As noted above, BusinessNZ does not consider the proposals as described in the consultation document to have merit. However, if they are pursued further then they are each significant enough in their own right, given their potential impact on the operation of the NZETS, to warrant separate, careful and substantive consideration prior to their inclusion in the Act. The current consultation process does not constitute such consideration. This consideration must include how they would be implemented. Finally, the use of empowering clauses should be avoided. Instead, the outcome of the separate, careful and substantive consideration should be written into the Act (for example, as the initial five year domestic cap pathway and the level of the import limit).

A New Approach to ETS Policy Making Needed

Consistent with the desire to avoid constant tinkering and the regulatory uncertainty, and unnecessary economic cost that comes with it, BusinessNZ considers that a new approach to ETS policy making is needed.

The problem is that to date, policy has been largely based on guesswork about where international settings (both with respect to the climate change negotiations and to action taken by other jurisdictions). Having based policy settings on these guesses, this has inevitably led to a need to change the NZETS settings as new guesses about where the international settings are heading. The heroic assumption, made just before the Copenhagen climate change conference that a deep and liquid carbon market will have developed by the end of 2012 based on our trade competitors having taken action to price carbon, and that would justify the rolling off of the moderating features, is a case in point. It is important that we don't fall into the same trap going forward but with a new (2015) date.

BusinessNZ can detect a desire to address this problem in the consultation document. In order to avoid having to change the NZETS settings based on new guesses about the international settings, the new approach is to implement changes that enable the Government to make changes to some critical NZETS design features at some later time as new information about international settings comes to hand. This approach avoids the pitfall of having to make guesses now about where the international settings might get to later. However, for the reasons outlined above, the new approach sets a different, but equally damaging set of risks in train.

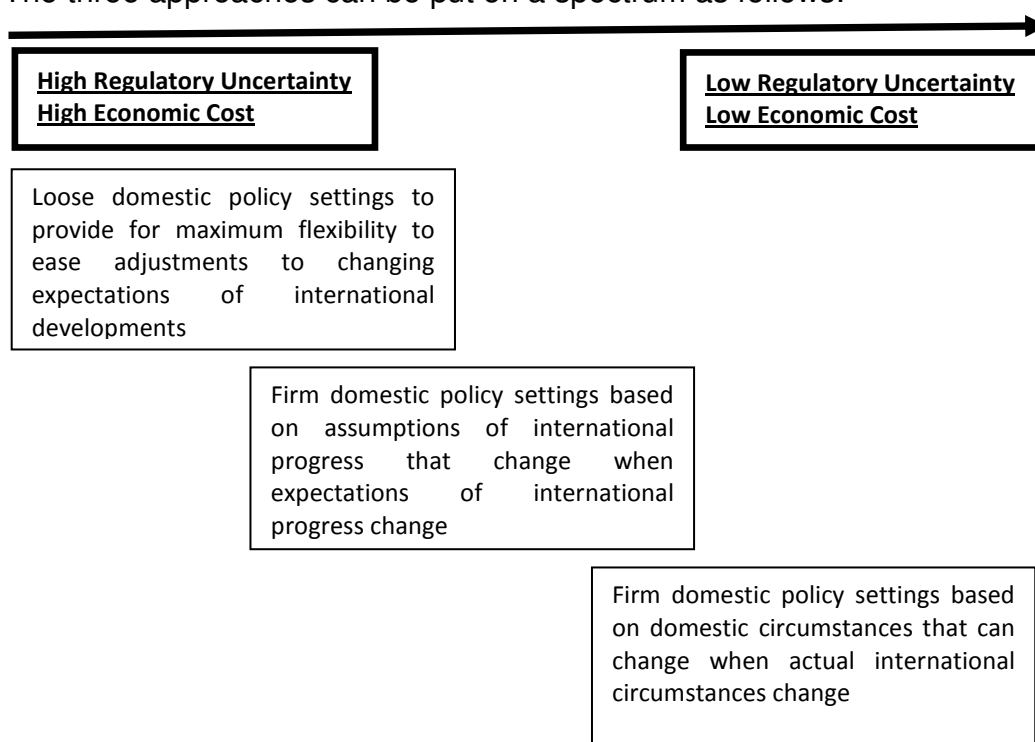
A third way is required. This third way is not novel, or in fact new but an orthodox approach to policy making in a highly uncertain environment. This approach is no more complex than making the changes now that can be justified by firm evidence, and no more.

The key to this approach (described in more technical terms in footnote one above) is to only make further changes when they can be justified by observation. This takes the guesswork element out of the equation and allows New Zealand to control its own policy destiny. In practical terms, this means setting out a clear policy pathway (an *actual* pathway and not one that

simply sets a framework that allows for an unknown set of possible policy responses to be implemented at some later point). Reacting to firm information about the nature and form of the new international climate change agreement, or international carbon market, allows an informed policy discussion to be had about what this new information might mean in terms of the design of the NZETS. The proposals to incorporate the new forestry offsets rule is a case in point.

In BusinessNZ's view, such an approach to the development of domestic climate change policy settings would be consistent with what the Government is doing in regard to its approach to international climate change policy development – in other words, saying let's wait and see about what others are doing before making firm commitments.

The three approaches can be put on a spectrum as follows:



The fact that the conversation can be based on *actual* information has the advantages of stakeholders being able to see that:

1. a change to the design of the NZETS is justified, based on the new information and not just a nice idea that might be helpful at some future point of the scheme's evolution; and
2. it will have implications for the design of the NZETS (rather than having to guess what impact a possible outcome may have on the NZETS).

In doing so, BusinessNZ considers that such an approach based around better information and a richer, more informed conversation, will help reduce the current high level of regulatory uncertainty, along with its associated cost.

Implications for Linking

Such an approach will clearly have implications for linking. To consider linking with, for example, Australia at the current point in time would be akin to trying to hit a moving target.

Trying to establish a durable policy setting on the current state of information of the Australian situation is the very risk that underpins BusinessNZ's desire to change the approach to policy making for the NZETS and underpins the point made earlier about policy-making in a highly uncertain environment. BusinessNZ considers that it is better to proceed on the basis as if we are *not* going to link with Australia, and return to this issue only once a clearer, more stable situation has emerged. To try to align our schemes now would be unnecessarily adventurous.

It is pure serendipity and not good planning that we are now not already faced with an amended Act that has been changed to allow linking with Australia but that would, based on current information, now need to be unwound. Let's learn from this opportunity and not simply blindly push on and foreclose on options before actual information comes to hand that can result in better policy choices being made.

Summary

The consultation provided an opportunity to stand back, and rather than continuing to pin our hopes on the anticipated actions of others, determine what New Zealand's contribution should be into the medium term, and how the costs and benefits of that should be fairly apportioned. This would have provided participants with a more predictable outcome and one in which they will have greater certainty in which to invest and create jobs. Unfortunately, this opportunity was missed.

This, combined with the dubious rationale for the proposals, is likely to further undermine the nascent New Zealand trading market. Opportunistic design changes aimed at delivering short-term, non-market outcomes will only create uncertainty. More worryingly, it risks causing businesses to lose confidence in a market whose design settings will become unpredictable and subject to the vagaries of changes to distant markets that are inappropriate for New Zealand economic and environmental circumstances.

We appreciate that a higher price signal will benefit some businesses. However, the issue is whether the benefits for a small number of businesses outweighs the costs on the remainder of the economy. BusinessNZ is not convinced.

BusinessNZ believes that its recommendations are a pragmatic response to the enormous difficulty inherent in the trade-off between tackling the issue of carbon market uncertainty while preserving the effectiveness of the approach set out in the NZETS. The recommendations preserve New Zealand as a

good place to invest and combined with other policies, New Zealand's commitment remains credible.

BusinessNZ looks forward to working closely with you as the proposals are given more scrutiny.

Yours sincerely

A handwritten signature in black ink, appearing to read 'John A Carnegie', with a stylized flourish at the end.

John A Carnegie
Manager, Energy, Environment and Infrastructure
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.