

Submission

by

Business|NZ

to the

**Honourable Pete Hodgson, Convenor,
Ministerial Group on Climate Change**

on the

**Kyoto Protocol – Ensuring our Future,
Climate Change Consultation Paper**

One of Business New Zealand's key goals is to see the implementation of policies that would see New Zealand retain a first world national income and to regain a place in the top ten of the OECD in per capita GDP terms. This is a goal that is shared by the Government. It is widely acknowledged that consistent, sustainable growth in real GDP per capita of well in excess of 4% per annum

(and probably closer to 7-8%) would be required to achieve this goal. Continued growth of around 2% (our long-run average) would only continue New Zealand's relative decline.

The health of the economy also influences the ability of a nation to deliver on the desirable social and environmental outcomes that we all want. First class social services and a clean and healthy environment are possible only in prosperous, first world economies.

Executive Summary

Business New Zealand believes climate change is an important issue and the business community wishes to participate in and contribute to the discussion on what role New Zealand plays.

We are of the view, however, that the policy development framework, consultation time-frame and proposed legislative process outlined in the consultation document, "Kyoto Protocol – Ensuring our Future", are seriously flawed and are likely to deliver perverse outcomes.

We do not believe that the current declared intention of ratification of the Kyoto Protocol is the correct one. Ratifying ahead of our trading partners and in the absence of robust analysis of the wider economic and growth consequences is not an economically or socially prudent course to pursue. An economy of our small size, location and fragility should be a follower not a leader in terms of potentially added costs.

The Government is proposing that New Zealand should ratify the Kyoto Protocol before the costs and economic implications are clearly known.

Analysis of selected industry sectors indicates potentially large social and economic costs.

There has been no comprehensive analysis of what ratification may mean for our international competitiveness, particularly in terms of Closer Economic Relations with Australia or for current or likely closer economic partnerships.

Awareness of the implications of climate change and the Kyoto Protocol remains low within the mainstream of the New Zealand business community that is typified by very small enterprises.

The environmental benefits and opportunities for innovation asserted by Government have not been subjected to rigorous evaluation and economic analysis.

The potential “leakage” of significant industries to non-Annex 1 countries, or the foreclosed growth potential of those remaining is a very serious concern.

Business New Zealand rejects any case for New Zealand to take a global leadership role in terms of climate change given the insignificance of New Zealand’s assessed contribution to global warming. We are of the view Government should suspend the current “rush to ratification” until the analysis highlighted above has been carried out and given full and careful consideration, including proper consultation with its Treaty partner.

Policy Development

One of the most serious barriers to allowing an effective evaluation of the potential costs/benefits of applying policy measures intended to mitigate climatic effects is the uncertainty over what those measure(s) may be.

The two part legislative programme, calling for formal ratification before the policy measures are decided, effectively denies any serious consideration of potential impacts on the economy. Because of this approach, such analysis that has been done has been forced to make a number of speculative assumptions.

It would seem reasonable and logical to halt the current programme, conduct an in depth economic evaluation of the suite of possible policy measures, identify the least-cost and most “climate effective” measure(s), investigate the practicality of implementation and then consider the costs/benefits of ratification.

We note there is no pragmatic, environmental or legal reason of any consequence requiring this country to ratify the Protocol by September 2002. With the first commitment period not commencing until January 2008 there is ample time to allow reasoned consideration of the uncertainties outlined above.

Unique Features of the New Zealand Economy

The declared intention of the Government is to ratify the Kyoto Protocol by September of next year. This will very likely be in advance of several of our significant trading partners including Australia, USA, Japan and several non-Annex 1 countries.

New Zealand’s economy in both scale and structure is unlike any of our trading partners and Business New Zealand believes inadequate attention has, to date, been given to these factors:

- historically, the economy has enjoyed an abundant supply of comparatively low cost energy. This has led to the development of high energy intensity activities;
- few energy substitution options are available;

- the New Zealand economy, in contrast to many of our trading partners, has a large energy intensive primary processing sector and a small service sector;
- agriculture emissions are very high compared with elsewhere;
- the demographic spread and physical topography of the country, combined with deregulation in the transport industry has led to a high emission component from the transport sector;
- only a small domestic market is available and the national economy is increasingly dependent on often distant export markets;
- the economy has demonstrated low historical growth rates relative to all our major trading partners.

Overcoming our low growth profile will require significant policy prioritisation together with ingenuity and innovation in overcoming the tyrannies of distance and size. Any impediment of whatever nature placed upon our productive sectors that is not simultaneously placed upon our trading partners will serve only to further inhibit the prospects of growth for the economy.

While there has only been limited initial work done on possible effects on the overall national economy, several pieces of analysis looking at particular sectors have recently been released.

These do not paint a reassuring picture. A recent joint Government/industry report on the forestry sector, for example, identifies a number of potential negative outcomes for that sector. Given the increasing prominence of forestry in the national economy (the “wall of wood”) the results of this study point to the need for further and more detailed analysis.

Business New Zealand believes it is neither productive nor useful for such studies to become the subject of acrimonious debate and counter-claim. We are of the view that all reputable economic modelling work, no matter who it is commissioned by, should be viewed and utilised as a contribution toward developing a better understanding of the potential impacts of political decisions taken in reference to climate change.

International Competitiveness

Business New Zealand submits it is a truism that if one country’s products and services face costs beyond those faced by a trading partner or competing nation that country will be placed in a position of competitive disadvantage.

While the potential costs of measures associated with the Kyoto Protocol are far from clear, prudent risk management dictates that it must be assumed there is the potential for added costs for our exporters.

We believe this issue to be of critical importance. Recent figures show¹ that of the top twenty export destinations for New Zealand production, the top three, Australia, USA and Japan, have not yet committed to ratification and of the remaining seventeen, eleven are non-Annex 1 countries. It is of particular concern that our two top export markets have made quite specific comment regarding their unwillingness to ratify at this stage, with both citing potential trade inequities.

Energy is a significant input to the production process for many of our exporters and with limited opportunities to switch to lower emission sources the export community may face significant input cost increases not faced by competitors elsewhere.

It is also important to note that many of our commodity-based exports compete with non-Annex 1 countries.

Given the importance of exports in advancing our national growth goals Business New Zealand believes it is essential that the various sectors of our export economy are subject to rigorous and extensive analysis prior to any consideration being given to ratification.

Business New Zealand also perceives a contradiction between the intent for early ratification and our official stance at international trade negotiations. In fora such as the WTO and APEC New Zealand regularly argues for the early elimination of trade distortions. Applying some of the domestic fiscal policy measures that have been suggested in terms of Kyoto in advance of similar measures from our trading partners would appear to be introducing exactly the kind of distortionary measures we argue against elsewhere. It is also a fundamental of New Zealand's trade policy that any concessions we may offer should capture equal or greater benefits.

Kyoto Protocol awareness

Business New Zealand is firmly of the view that there currently exists a widespread misunderstanding and lack of awareness of the climate change issue and its implications.

The current consultation process is only reaching a very limited audience within the commercial community and that audience tends to have some familiarity with climate change matters.

Failure to correct this situation will result in ineffective responses in areas such as energy efficiency and emission reduction and will create inequalities within the national economy.

¹ "Overseas Merchandise Trade (Exports) October 2001", Statistics New Zealand, 12 December 2001

Recent figures show² that there are 17,790 enterprises with 10 to 49 employees, 1,452 with 50 to 99 employees and 1,307 with 100 plus employees (all non-farming). In Full-time Equivalent Persons (FTE) terms these enterprises collectively employ 969,150 persons. It is also worth noting that with 193,450 FTE's, the manufacturing sector is the largest employer of the various sectors analysed.

The lack of awareness, and thus preparedness, among the majority of these enterprises has the potential to severely impact on investment decision making and also has the potential, in the event of any precipitate or ill-considered decisions regarding fiscal measures, to significantly impact on employment.

Business New Zealand submits that the declared time frame precludes the wider business community from the consultation process. We believe that this is a significant failing of the current process.

Benefits and Opportunities

There has been much official, consultancy community and media comment on assertions of the alleged environmental benefits and opportunities for innovation that will emerge from ratification of the Protocol.

Business New Zealand encourages and supports new innovation in the energy and environmental areas. There are clearly many innovative and desirable opportunities in areas such as insulation, alternative energy sources and transport and infrastructure advancements.

These are not, however, contingent on ratification of the Kyoto Protocol. It is our contention that policy measures associated with the Protocol may, under the current scenario, in fact inhibit such innovation.

We would also note that a number of other resource use and policy actions have generated scepticism within the commercial community over the likelihood of growth and innovative opportunities emerging from Kyoto Protocol ratification.

These include the continuing inaction over the Resource Management Act amendments, compliance costs associated with the Hazardous Substances and New Organisms Act, energy conservation and waste strategies that lack credible cost benefit analysis and the continuing impacts of sharply higher electricity costs.

Business New Zealand believes far greater attention needs to be given to actively encouraging innovation rather than presenting policy initiatives that are often perceived as impediments.

² "New Zealand Business Demographic Statistics as at February 2001", Statistics New Zealand, 26 September 2001.

The “Leakage” Question

A further area that requires in depth analysis involves the impacts that early ratification may have on regional employment, social well-being and economic development. We refer here to investment decisions made by large high energy using regional manufacturing facilities.

Industries such as cement facilities, steel makers and pulp and paper processors operate on relatively thin margins and are subject to volatile international pricing structures.

Simply the suggestion that there may be potential added costs for energy inputs may cause overseas owners to review investment plans for New Zealand located facilities. In addition, if added energy costs were to be faced here but not in a non-Annex 1 country closer to their markets this could become a very strong incentive to relocate some or all production to such a country.

We are also aware that the extreme volatility of last winter's electricity market has had a negative flow on effect in terms of the perception of New Zealand as a favourable investment environment. We have been made aware of several plant upgrades and expansions that have now been shifted to facilities elsewhere. Uncertainty regarding forward energy pricing has often been offered as an explanation.

Business New Zealand submits that this situation cannot be allowed to escalate. Energy pricing and Government moves on the Kyoto Protocol are not unrelated. A robust evaluation of the key requirements for attracting major industrial investment needs to be conducted prior to any ratification moves.

Global Leadership

The consultation document reiterates comment made elsewhere regarding our international reputation and our ability to encourage other nations. Business New Zealand submits that this is totally inadequate justification for the significant economic impacts that early ratification would ensure.

Our contribution to global warming is very small and our economy is very fragile. Early ratification by New Zealand will have no effect on the stance of the United States or Australia, nor would our ratification see comparable domestic measures adopted by our non-Annex1 trading partners.

Rather than pursuing an unattainable goal of global leadership, it would be a far more responsible course of action to carefully analyse and evaluate a range of

measures that promote sustainable growth and social equity and deliver exportable, innovative climate change mitigation concepts and technologies.

Conclusion

Given the series of uncertainties surrounding the question of Kyoto Protocol ratification, Business New Zealand submits that the Government should reassess its ratification programme pending robust economic analysis of the consequences of ratification against a range of likely scenarios and through consultation with all of those impacted.