Submission

by

Business|NZ

to the

New Zealand Climate Change Project

on

"Climate Change – The Government's Preferred Policy Package – Discussion Document, April 2002"

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1. INTRODUCTION

1.1 This submission is made on behalf of Business New Zealand, incorporating regional employers' and manufacturers' organisations. The regional organisations consist of the Employers and Manufacturers Association (Northern), Employers and Manufacturers' Association (Central), Canterbury Manufacturers' Association, Canterbury Employers' Chambers of Commerce, and the Otago-Southland Employers' Association. Business New Zealand represents business and employer interests in all matters affecting those sectors.

1.2 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.

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

2. Business New Zealand and Climate Change

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

2.2 Business and industry are seeking as much certainty as possible, particularly on issues such as the Kyoto Protocol that are of greater economic than environmental significance for the medium to long term. Uncertainty and equivocation will not attract investment or reinvestment. Nor are they conducive to a balanced growth strategy that would enable quality environmental policies, including climate change policies.

2.3 Rightly or wrongly, climate change is regarded as one of the most significant environmental issues facing the planet. This is despite continued uncertainty about the exact extent of global warming and to what influence human behaviour has had on the degree of any warming. However, the fact that governments around the world, including New Zealand's, are taking climate change so seriously means that the business community must do so as well.

2.4 Business New Zealand is not in a position to debate the science of climate change and does not wish to do so. We have and will, however, vigorously debate the economics of proposed actions to deal with climate change, most notably ratification of the Kyoto Protocol. Until recently climate change has been regarded as being 'just another environmental issue', but we are heartened that, in common with a number of other countries, New Zealand has more recently recognised that it is an issue that has critical economic ramifications. The capacity of the Protocol to achieve its stated outcomes against its likely cost is also a matter of serious concern.

2.5 The Government's assessment to date is that whilst the costs of climate change are potentially large, the overall economic costs to New Zealand of implementing the Kyoto Protocol are likely to be relatively small and, taking into account forest sink credits, could possibly even be mildly beneficial. The precise economic impact will depend on which domestic policies are selected for implementing the Protocol. However, New Zealand's unique characteristics mean that the burden of ratification could be particularly heavy for this country.

2.6 Our concerns are primarily related to the implications of policy initiatives on New Zealand's international competitiveness:

- energy is a key input in New Zealand, and low cost, abundant energy is one of New Zealand's few competitive advantages. Increasing the cost of emissions will reduce our economic growth prospects more than other, less energy intensive economies. This will hamper New Zealand's efforts to improve our OECD rankings;

- the choice of 1990 as a benchmark year is particularly disadvantageous for New Zealand. New Zealand was in the depths of a severe recession in 1990, so emissions were at a particularly low ebb in that year, and over the past decade New Zealand's energy intensity has increased due to the increase in energy intensive industries such as dairying;

- New Zealand industries are particularly vulnerable to competition from countries that will be outside the Protocol or which will refuse to ratify. More so than European countries, for example, our commodity based primary exports compete against those from Australia, the United States, and particularly developing countries in Asia and Latin America. Any increase in production costs will adversely impact on New Zealand's international competitiveness;

- New Zealand's geography puts us at a disadvantage. We have high transport costs per unit of GDP and energy intensive industries remain at risk of relocation to lower-cost developing countries closer to our main markets. These developing countries will not be subject to the cost increases New Zealand would face from implementing the Protocol;

- New Zealand's growing population makes achieving any emissions reduction targets particularly difficult (New Zealand's population is now over 12% higher than 1990, and growing at a rate of around 1% per annum). It is no coincidence that those European countries most enthusiastic about the Protocol have static or declining populations; and

- forest sinks offer only limited potential to offset abatement costs and there are complex and significant issues surrounding the property rights of forest owners and forests planted prior to 1990.

2.7 For all these reasons, New Zealand should take full account of developments and decisions made by our significant trading partners, particularly Australia, Canada, Japan, and the United States. While European markets are important to New Zealand, we have more in common with Asian and Latin American economies, which will not be subject to Kyoto obligations.

2.8 For all the reasons set out above, we continue to oppose ratifying the Kyoto Protocol at this time and believe the preferred policies need to be subject to rigorous analysis prior to implementation.

2.9 We wish to stress, however, that doing nothing is not an option. Instead, New Zealand should continue to monitor carefully what other countries, particularly our significant trading partners, are doing to address climate change.

2.10 We note that, while rejecting ratification, the United States has taken a strong leadership role in this regard. It has decided that for now at least Kyoto is not a credible way forward and it has announced a set of unilateral measures that it believes will reduce greenhouse gas emissions without harming its economy. Australia has recently entered into a climate change ‘partnership’ with the United States, and Canada is also exploring a similar approach. New Zealand should be looking very closely at these developments in order to ascertain the scope for partnership and the capacity to influence policies that would impact on some of the largest and wealthiest global economies whose emissions policies are critical to effective global action.

3. The Preferred Policy Package

3.1 Business New Zealand acknowledges that, with or without ratification of the Kyoto Protocol, new domestic policies are required to address climate change.

3.2 Climate change policies must, however, complement a growth strategy that has a goal of returning New Zealand to the top 10 of OECD countries in the medium term. In view of this, such policies must be consistent with the following overarching principles:

- long term and gradualist – while a carbon free economy may one day be possible, it will take decades rather than years to achieve without severe economic and social dislocation;

- enhancement or at the very least preservation of New Zealand’s international competitiveness – policies must take full account of those of our significant trading partners;

- equity – policies should be fairly and consistently implemented across all sectors of the economy and society;

- avoidance of carbon-leakage – emission-intensive industries must not be driven overseas; and

- environmental integrity at low cost – New Zealand emissions should be reduced, or at least stabilised, on a per capita basis.

3.3 <u>The Foundation Policies:</u>

3.3.1 The discussion document identifies several "foundations" to climate change policy that it is contended will underpin actions during the first commitment period. Business New Zealand believes the success of those "foundations" will be jeopardised unless several structural and regulatory issues are given attention. These include:

- an improved depreciation regime for plant and machinery to encourage the replacement of outdated technology that is often less energy efficient and thus unlikely to underpin effective climate change strategies. In addition to direct application at an enterprise level, there are also strong infrastructural arguments for accelerating change. For example, outdated thermal electricity generation capacity is not being replaced. New technology gas turbine plants produce the same amount of electricity with half the gas of the older plants;

- immediate reform of the Resource Management Act is needed to encourage new development, including renewable and advanced fossil fuel technologies. The RMA currently presents barriers to the development of hydro, distributed (i.e. localised and often relatively small-scale) and wind generation This has, for example, seen over recent years a marked decline in consents for new hydro and geothermal facilities. In addition, the reform should include provisions that explicitly exclude process and/or efficiency targets being included within resource consents. We wish to stress, however, that amending the RMA to allow for such developments must be done in the context of wider reform. We would not support reform being limited to an industry specific amendment (e.g. wind generation). Such an approach was never the intent of the legislation and, if progressed, would suggest that the Government was attempting to "pick winners". The development of climate change and energy policies highlights the need for a fundamental review of the Act and, as a minimum, we would urge the Government to immediately implement the recommendations made by the 1999 Ministerial Reference Group;

- obstacles to improved electricity transmission infrastructure need to be urgently addressed. Failure to do so will hamper the development of new and innovative distributed generation opportunities and limit the most efficient use of hydro resources;

- it is critical that there be accelerated promotion of efficient energy technologies and R&D programmes with a particular emphasis on small to medium enterprises (SME's);

- substantial reform of road pricing, funding, investment and management would significantly improve efficiency in the road transport sector. Some modelling has already been done on the GDP benefits of investment in better roads and given the continuing decline of rail alternatives, better roads will be increasingly important for transport emission reductions. The recent roading announcements were positive for the commercial road transport sector but the lift in funding for increased road construction is insufficient if New Zealand is to achieve the targeted increase in economic growth;

- a rigorous oversight programme needs to be implemented to ensure that the proposed new local government reforms do not create barriers and impediments to innovation and growth, or inequitable emission mitigation regimes in different geographic regions. In particular, we note that members of the Cities for Climate Change Protection Programme will be required to develop their own inventories, and set their own greenhouse gas reduction targets. Local government reduction plans create the significant risk of duplicating or even conflicting with national policies and increasing business compliance costs; and,

- the Government needs to actively promote, in partnership with business and industry associations, understanding of the issues surrounding climate change to the wider business sector sector. Business New Zealand recently conducted a survey of its membership seeking feedback on several issues surrounding climate change. Over 500 responses were received from both large and small enterprises. 85% of respondents indicated ignorance of the waste and renewable energy targets, while 94% did not believe they had adequate information on the potential costs of proposed policies to allow them to adequately forward plan. Lack of awareness to this scale does not bode well for the success of the foundation policies. This is of particular concern in that the success or failure of the preferred policy package appears to very much depend on the success or failure of the "foundations". The NEECS targets, for example, are ambitious and if they are to be achieved they will require the participation and support of a far broader swath of the economy than the survey results suggest currently exists.

3.4 <u>Competitiveness-at-risk group:</u>

3.4.1 As noted above Business New Zealand is of the view that a climate change policy package should both avoid driving any industry off-shore and be equitable in application across the economy. In regard to the latter point, we view with some concern the lack of detail in the "high level criteria" (defining "competitiveness-at-risk") identified in page 31 of the discussion document. This lack of detail makes it difficult to determine what size or type of enterprise would be eligible for the so-called "sheltering", or Negotiated Greenhouse Agreement (NGA).

3.4.2 Comments from officials suggest, however, that the intent may be to allow only a limited number of enterprises to qualify for "shelter". Business New Zealand strenuously rejects such an approach that would be inequitable and would suggest that the Government is entering the risky area of "picking winners" across the economy

3.4.3 We note that Statistics New Zealand reports that 1,452 enterprises have between 50 and 99 staff and a further 1,307 have over 100 staff[1]. Many of these companies are active in export markets and, while for some energy may not be their major input, <u>all</u> will be impacted by rising costs implicit in the Government's preferred policy package. It would, therefore, appear logical and equitable and less likely to introduce distortion into the economy to allow <u>any</u> enterprise to apply for "shelter" or an NGA.

3.4.4 Clearly this would require the development of flexible criteria to allow for differing activities, but the overall goal for all participating enterprises would be measurable efficiencies to a specified level. Business New Zealand would welcome the opportunity to work with officials in developing such criteria.

3.4.5 We would also seek dialogue with officials regarding the proposed target that an NGA is to be based around. Page 32 of the discussion document states that, *"…an NGA will be based around developing a pathway and timeline for the firms to achieve international best practice in emissions management. In the event that negotiations do not result in an agreement that reaches best practice within an acceptable timeframe, a partial charge may be negotiated".*

3.4.6 This target, as defined, is in our view unworkable. Energy capital stock, like other capital stock, has a long lifetime. "Best available" technology will always be better than existing plant. It is not economic, and would be fiscally irresponsible, for an enterprise to scrap existing plant every time a technological advance occurred. Similarly, it would be unrealistic to expect a New Zealand manufacturing facility to have to totally upgrade because a "state of the art" facility in the same manufacturing sector opened in, say, China.

3.4.7 NGA targets need to be determined on a case-by-case basis, recognising the nature and dynamic of the New Zealand productive sector, including its small size and distance from markets, and always be based on the least-cost principle.

3.5 <u>Projects:</u>

3.5.1 The Preferred Policy Package states that a project is an activity that delivers a defined reduction in greenhouse gas emissions in return for which Government provides an incentive. While Business New Zealand supports the general concept of projects we are of the view that careful evaluation needs to take place in several areas including:

[1] New Zealand Business Demographic Statistics: As at February 2001. Table 1

- the mechanism should not be used to subsidise or support operations that would not have long term viability in the absence of project funding;

- interventions need to be carefully focussed if targeted at specific market failures resulting from the climate change programme;

- any proposed intervention needs to be carefully evaluated in terms of the potential for distortionary market effects or other unintended consequences, and,

- the role of the project mechanism with NGA signatories needs to be determined.

3.5.2 Business New Zealand would welcome the opportunity to assist with the development of the project mechanism.

3.6 <u>Carbon Tax:</u>

3.6.1 The vast majority of businesses and consumers will fall under the “General Energy Users Group” category and the key policy measure for this group is a carbon charge capped at $25 per tonne of carbon.

3.6.2 The Preferred Policy Package seems to suggest that higher CO_2 emissions costs (the “carbon tax”) will incentivise businesses to reduce energy use by employing increasingly sophisticated energy efficiency techniques. Those who cannot, or will not, are expected to pass on the additional costs to consumers who, it is assumed, will modify their purchase patterns in response to higher cost products. The cumulative effect is intended to alter behaviour and result in emission reductions.

3.6.3 Setting aside the uncertainty of what the international price of carbon might be, Business New Zealand does not support the proposed carbon tax and believes the logic behind it to be seriously flawed. Increased costs will not encourage the uptake of efficiency technologies. It is far more likely that the negative impact of increased energy pricing will constrain economic growth, dis-incentivise the uptake of new technologies and limit the availability of new product choices.

3.6.4 Doubts have been expressed about the desirability or even the ability of taxes “on undesirable activities” (e.g. energy, alcohol, tobacco) to change behaviour. In regard to energy, because of the low inelasticities of demand such taxes would need to be set at a very high (and thus economically unsustainable) level to achieve any change in behaviour.

3.6.5 We noted above that comparative low cost energy has been one of New Zealand’s few competitive advantages and would contend that a fundamental, underlying tenet of climate change policy should be that the New Zealand economy is not subject to any artificial energy price increases in advance of comparable action by our trading partners.

4. Conclusion and Recommendations

4.1 Business New Zealand does not believe the Government's decision to ratify the Kyoto protocol at this time is the correct one. We recognise, however, that there is a need to address climate change strategies and wish to actively participate in the policy development process. That policy process needs to be firmly guided by overarching principles and needs to be fully cognisant of New Zealand's international competitiveness. Any policy measure must reflect both equity and least cost.

4.2 Our consideration of the Preferred Policy Package has also highlighted the potentially high compliance costs associated with the climate change programme. There are likely to be high administrative costs associated with the "shelters" process and the Project Mechanism, and we note the potentially considerable costs associated with related Government activities. The Climate Change Response Bill, for example, suggests an extensive and expensive inventory regime with initial annual administrative costs estimated to be $4,624,000.

4.3 In an effort to arrive at an effective and workable climate change strategy Business New Zealand recommends that the Government:

- implement an improved depreciation regime to help facilitate the introduction of more efficient technologies;
- commence an immediate and fundamental review of the Resource Management Act with a view to removing barriers to new developments and excluding restrictive consent conditions;
- urgently address electricity transmission infrastructure issues;
- accelerate the promotion of efficient energy technologies and R & D programmes to the SME sector;
- introduce substantive reform of the roading infrastructure;
- apply rigorous oversight to the local government sector;
- enter into a partnership with the business community to more effectively promote awareness of the climate change issue to that community;
- work with Business New Zealand to improve criteria and equity in determining eligibility for "sheltering";
- carefully evaluate and consult widely on the applicability and methodology for activating the project mechanism, and
- review the decision to implement a carbon tax, giving full consideration to the equity and competitive disadvantage issues.