



MAJOR ELECTRICITY USERS' GROUP

28 March 2007

Mr Phillip Gurnsey
Manager
Post-2012
Ministry for the Environment
By email to climatechange@mfe.govt.nz

Dear Phillip

Submission on Post-2012 climate change policy discussion paper

1. This is a submission by the Major Electricity Users' Group (MEUG) on the *Discussion paper on measures to reduce Greenhouse Gas Emissions in New Zealand post-2102* (the "post-2012 paper") published by the Ministry for the Environment on 11th December 2006. On the same date the Ministry of Economic Development published a companion report, "*Transitional measures – Options to move towards low emissions electricity and stationary energy supply and to facilitate a transition to greenhouse gas pricing in the future*" (the "transitional paper").
2. In this submission MEUG:
 - a) Notes climate change is a serious long term global issue because poorly co-ordinated international actions may harm the global economy and New Zealand may implement policies that harm our economy without making any difference to global greenhouse gas emissions (paragraph 3 to 8 of this submission);
 - b) Raise concerns that government perceives proposed climate change policies to have a "moderate cost" on the economy and Ministers are considering "bold goals and objectives" when no cost benefit analysis has been undertaken (paragraph 9 to 12);
 - c) Welcomes the post 2012 paper as the "start of a dialogue" and suggest the further detailed discussion paper planned for 2008 take a more holistic approach to discussing New Zealand's climate change response strategy (paragraph 13 to 15);
 - d) On the specific options in the post-2012 paper MEUG (paragraph 16 and 17):
 - i) Supports the goal of promoting internationally agreed market or price based measures post-2012, including an international carbon charge as an option;
 - ii) Agrees with the preference of Ministers to implement measures "consistent with New Zealand's economic and sustainable development interests and the longer-term international climate change policy framework";
 - iii) Prefers market mechanisms over regulatory standards and restrictions;
 - iv) Agrees with the post-2012 paper preference for broad based rather than sector specific market instruments; and
 - v) Recommends keeping all options open and to undertake detailed design once international arrangements start to materialise rather than attempting to predict that outcome and commencing detailed design now.

Climate change risks

3. The post-2012 papers commence with a statement by the Minister Responsible for Climate Change Issues¹:

"Climate change is a serious global problem, probably the most serious challenge our planet faces in the 21st century."
4. The post-2012 paper provides no reference as to how government reached this conclusion and how other serious challenges to the world were weighed.
5. Climate change is a serious problem because of uncertainty regarding the science of observed trends to date leading to uncertainty in forecasting future effects on the global environment. Overlaying these uncertainties around the physical science are difficulties in modelling the effect on the global economy including the rate of technological change that is likely. Finally there are the uncertainties of the political agenda of countries and individual politicians. The risk of over-reaction buoyed by opportunistic politicians is as great as failing to take even small reasonable actions.
6. Climate change is a serious long term global issue because:
 - a) poorly co-ordinated international actions may harm the global economy; and
 - b) New Zealand may implement policies that harm our economy without making any difference to global greenhouse gas emissions.
7. There has already been evidence of over-reaction in New Zealand with the call by the Prime Minister for New Zealand to become carbon neutral even though no cost benefit analysis of that policy has been undertaken. The idea of going carbon neutral policy was only briefly mentioned in the draft NZ Energy Strategy².
8. This is no time for knee jerk actions. The bigger the perceived problem, the greater the importance of analysing the problem, considering all options and choosing policies that are least cost and overall welfare enhancing.

Lack of analysis

9. The post-2012 paper states³:

"Changing business-as-usual practices to reduce emissions will impose a moderate economic cost, as well as generating economic and other opportunities."
10. And later⁴:

"Cabinet has invited Ministers to consider 'bold goals or objectives' as part of their ongoing sectoral work programme responsibilities."
11. MEUG note that government has not undertaken any cost benefit analysis of all options before making the above comments or direction to Ministers. It is of grave concern to MEUG that government perceives proposed climate change policies to have a "moderate cost" on the economy and Ministers are considering "bold goals and objectives" when no cost benefit analysis has been undertaken.
12. It is essential that government conduct robust cost benefit analysis of all options before either making final decisions for post-2012 policies or speculating what the outcome of those analysis might be.

¹ Post-2012 paper, p1, foreword by the Minister

² Refer Draft NZES, 11 December 2006, refer foreword by the Minister of Energy, p3, "This strategy shows how New Zealand can advance towards carbon neutrality"

³ Post-2012 paper, p3, paragraph 2

⁴ Ibid, p19, paragraph 1

MEUG welcome the post-2012 paper as the start of a dialogue but there is a need for a comprehensive climate change response strategy

13. MEUG welcome the post-2012 paper as the start of a dialogue⁵ with further consultation on a further more detailed consultation paper planned for 2008⁶.
14. The post-2012 paper, the transitional paper and the draft New Zealand Energy Strategy all cover some aspects of climate change policy but not all. For example consideration of how adaptation strategies might be developed, the important role of research and development, what strategies to take to position New Zealand in international negotiations and how to meet Kyoto Protocol obligations (eg credit purchase strategies) should be considered in an overall climate change response strategy.
15. MEUG welcomes the post 2012 paper as the "start of a dialogue" and suggest the further detailed discussion paper planned for 2008 take a more holistic approach to discussing New Zealand's climate change response strategy.

Comment on policy choices in the post-2012 paper

16. MEUG answers to the 26 questions in the post-2012 paper are set out in the appendix to this submission.
17. In summary the MEUG comments on key policy options follow:
 - a) MEUG supports the goal of promoting internationally agreed market or price based measures post-2012, including an international carbon charge as an option.

In New Zealand the option of a broad based carbon charge has been seen as being politically unpalatable since the government decided not to apply a carbon charge in late 2005. Hence the post-2012 paper (and the transitional paper) has tended to focus on trading mechanisms. A recent article by Dr Robert Shapiro⁷ has been very insightful in terms of some risks with trading that were not covered by the post-2012 paper. Dr Shapiro also makes the case for an international carbon tax as a better option. MEUG has no view at this stage on the proposition by Dr Shapiro; apart from suggesting government should not necessarily dismiss a broad based carbon charge consistent with international agreements post-2012.

- b) MEUG agrees with the preference of Ministers to implement measures "consistent with New Zealand's economic and sustainable development interests and the longer-term international climate change policy framework⁸."

New Zealand cannot assume other countries adopt similar measures. We need to monitor the policies of our trading partners and competing countries to ensure our measures are consistent.

- c) MEUG prefers market mechanisms over regulatory standards and restrictions.

Section 8 of the post-2012 paper considers two possible regulatory interventions.

The first are a range of amendments to the Electricity Act to tilt the playing field in favour of new renewable over new thermal investment. In a post-2012 world the focus preferably should be on economy wide measures rather than such sector specific approaches. MEUG is also wary of using such a regulatory approach when the benefits in terms of climate change mitigation are not clear. Only if there was clarity on what the climate change externality should be valued at (and that is a moot point), could such a

⁵ Ibid, p3, paragraph 5

⁶ Ibid, p7, paragraph 2

⁷ Dr Robert J. Shapiro, "Addressing the Risks of Climate Change: The Environmental Effectiveness and Economic Efficiency of Emissions Caps and Tradable Permits, compared to Carbon Taxes," refer http://www.sonecon.com/docs/studies/climate_021407.pdf

⁸ Post-2012 paper, p6

regulatory approach be used. But if government knew for sure what the climate change externality was that needed to be priced in, then government might as well use a market instrument rather than a regulatory instrument.

The second possible suite of regulatory interventions relate to the RMA. The paper discusses the possibility of restoring the ability of local government to consider climate change effects. Given climate change is a global phenomenon that needs global solutions it would be inconsistent and highly risky to allow local government to develop ad hoc approaches to mitigating climate change effects. The other RMA options relate to use of National Policy Statements or National Environmental Standards. Both would be relatively piecemeal and sector specific and therefore likely to be inferior to a broad economy wide market instrument. Therefore MEUG believe there would be little merit in pursuing these RMA options and instead resources should focus in developing economy wide market instruments consistent with international agreements post-2012.

- d) MEUG agrees with the post-2012 paper preference for broad based rather than sector specific market instruments.

The opening bullet point of the "straw man" proposal in the 2012-paper states⁹:

"The government would introduce a broad price-based measure for New Zealand at some date not earlier than 2012 and when international conditions were appropriate."

MEUG agrees with this first bullet point of the "straw man" proposal. In essence designing and implementing a raft of sector specific responses will lead to overlaps, gaps, inconsistencies, greater transaction and compliance costs and higher business uncertainty compared to a broad economy wide measure.

- e) MEUG recommends keeping all options open and to undertake detailed design once international arrangements start to materialise rather than attempting to predict that outcome and commencing detailed design now.

It would be high risk for New Zealand to pre-judge the outcome of international discussions and undertake detailed design earlier. There are probably some actions that can be taken in the interim because they will be necessary for any price-based measure, eg developing emission measuring standards.

Concluding comments

18. MEUG members would welcome an opportunity to brief or answer questions of Ministers or officials on the contents of this submission.

Yours sincerely



Ralph Matthes
Executive Director

⁹ Ibid, p50

Appendix: MEUG answers to the questions in the post-2012 discussion paper

The middle column lists the page reference of the question in the post-2012 discussion paper.

Questions	Refer.	MEUG comments
1. Do you expect international efforts to reduce greenhouse gas emissions to continue? If so, in what form?	p.15	<p>International efforts to reduce GHG likely to continue, ie significant technological work currently underway. At the same time international efforts to better understand the science, forecast the effects and model the economics of various scenarios needs to continue.</p> <p>Given better certainty on the economic effects globally, the ideal would be an internationally binding agreement on all countries to assist trading or an internationally agreed C-tax. Next best would be regional agreements under a broader international mandate. In either case NZ could develop policies.</p> <p>It would probably be welfare destroying for NZ to go it alone or enter into regional agreements that have no broad international framework.</p>
2. Do you believe a price-based measure such as emissions trading, which gives emitters the responsibility for at least some of their emissions, could enable businesses to find the lowest-cost way to reduce emissions?	p.15	Yes. A well designed C-tax could also.
3. Would you prefer directive regulations to a price-based measure?	p.15	Definitely prefer price-based measures.
4. What, if any, pre-conditions would need to be met internationally and/or domestically before a broad price-based measure such as a greenhouse gas charge or emissions trading was introduced in New Zealand?	p.15	More certainty on likely long-term international arrangements followed by a cost benefit analysis to ensure specific (internationally consistent) proposals will not harm the New Zealand economy.
5. Under what conditions should the government support or limit the use of domestic and international flexibility mechanisms by firms or sectors with emission reduction targets or obligations?	p.18	If decide to use these flexible mechanisms then should be as little constraints as possible.
Leakage and competitive issues:		
6. In the longer term, should the same price of emissions apply across all sectors of the economy? If not, how could the stringency of emission targets be determine for different sectors?	p.24	<p>In the long and short term the shadow price for climate change effects should be the same.</p> <p>Any differential treatment will result in inefficient resource use compared to the case where all sectors are treated the same.</p>
7. What measures should the government consider for managing the international competitiveness impacts of its climate change policies?	p.24	Measures that are not only effective but also transparent to the wider public
8. How might the government set a threshold for acceptable levels of	p.24	No comment

	competitiveness-at-risk impacts for firms subject to international competition?		
9.	What conditions would justify removal of any measures to deal with competitiveness issues?	p.24	International trading partners and competitors had equivalent climate change policies
10.	How should the government define and enforce a threshold determining which firms or sites should be included in the scheme? For example, should a threshold be defined on an intensity or absolute basis?	p.26	MEUG disagree with firm or site specific thresholds post or pre 2012. The least cost mitigation will be by implementing a broad economy wide market mechanism consistent with arrangements that have broad international acceptance.
11.	How could the government design a threshold to minimise competitiveness and equity problems?	p.26	No comment
Revenue recycling:			
12.	Should revenues from climate change policy measures be returned to the economy through either general tax relief or funding for targeted activities? If you believe revenues should be returned to the economy through funding for targeted activities, which activities should be considered?	p.28	No comment
Building capacity for strategic emissions management:			
13.	What assistance would large direct emitters need to prepare for mandatory monitoring, measurement and reporting?	p.28	Building capacity should be an economy wide initiative to support broad economy wide market mechanisms. Standards for measurements and reporting will have to be developed. Some of those will probably leverage and be consistent with international precedents. Others, such as CH ₄ measuring and reporting capabilities, New Zealand might find itself as the front runner because of our particular emissions profile.
Emissions trading:			
14.	Which sectors could and should be included in a New Zealand emissions trading scheme? Could this change over time?	p.38	All sectors
15.	What design conditions would be necessary for emissions trading to function effectively in the New Zealand context?	p.38	Effective measuring and low transaction costs
16.	Which allocation methods would you support: gratis allocation, auctioning or hybrid allocation schemes? Why?	p.38	Suggest more detailed work still needed and decisions may be influenced by design of international arrangements
Greenhouse Gas Charge:			
17.	Would a broad greenhouse charge be an effective policy option for reducing emissions in New Zealand post-2012?	p.41	Possibly yes. This option needs to be kept open when considering post-2012 options
18.	How should the rate of any broad-based greenhouse gas charge be set? Should it vary by sector, and if so, on what basis (the relative ease of mitigating emissions, the availability of alternative technology or the effect on emitters' decisions)?	p.41	The rate should be consistent across all sectors and set on par with the rate (or equivalent to the rate inferred) by our trading partners and competitors subject to ensuring the rate does not harm the economy
Other regulatory approaches:			

19.	Is it desirable to apply RMA controls on greenhouse gas emissions because of their impact on global climate change?	p.44	No
Emission reduction agreements:			
20.	What conditions would be required for emission reduction agreements to be used as an element of post-2012 climate change policy?	p.46	No comment
21.	What methods could be used to ensure that emission reduction agreements were sufficiently ambitious to meet government goals, and the commitments made would be met over time?	p.46	No comment
22.	What process could be used to develop emission reduction agreements for major direct emitters?	p.46	No comment
Comparison of Options:			
23.	What national and/or international circumstances would favour emissions trading rather than greenhouse gas charges applied broadly or more selectively across multiple sectors of the New Zealand economy post-2012?	p.48	If international agreement on trading rules proves difficult, it may be easier to have a consistent international tax rate agreed between annex 1 and or regionally similar groups of countries
24.	Would a price measure be sufficient to achieve the following types of climate change-related objectives: accelerated uptake of highly efficient technologies, development and commercialisation of new technologies, fuel switching to low emissions or renewable energy sources, and reduced energy demand?	p.48	Probably not and therefore the AP6 initiative appears to be worthwhile. NZ should continue to seek membership of AP6 and or access the technological advances made by AP6
25.	Under what circumstances should a regulatory approach be used in place of price-based measures such as emissions trading, a greenhouse gas charge or financial incentives?	p.48	As a last resort; even then the distortionary effects of regulation may preclude those options
Indicative proposal for discussion:			
26.	What are your views on the indicative proposal for discussion?	p.51	Comments on the indicative proposal (termed the "straw man") follow:
		Proposal (p50)	MEUG comment
		<ul style="list-style-type: none"> The government would introduce a broad price-based measure for New Zealand at some date not earlier than 2012 and when international conditions were appropriate. 	<p>Agreed.</p> <p>One important aspect not covered in the straw man proposal is that access to technology is critical because ultimately the solutions will be technical. Hence for example joining or a strong alignment with AP6 is strategically very important and should be part of the straw man proposal. The importance of access to technology is relevant for both New Zealand's' post and pre 2012 climate change response strategies.</p>

	<ul style="list-style-type: none"> • The types of conditions that would support the introduction of a broad price-based measure could include, among other things, the following: <ul style="list-style-type: none"> - NZ assumes a target, or otherwise participates, in an international; climate policy framework, whether on a national or sectoral basis; - The measure does not have significant detrimental impact on the international competitiveness of New Zealand's key producers because it expressly assumes most of our competitors would be doing something similar; - New Zealand can use the measure to access least-cost emission reduction opportunities, both globally and sectorally; and - The devolution of emissions liability and costs can be administered efficiently • The preferred price-based measure would be emissions trading unless future international conditions preclude the use of emissions trading. • Mitigation measures for major emitters implemented prior to 2012 should be consistent with a later move to a broad based price-based measure. • More specifically, these measures for major emitters should build their capacity to measure, monitor and report their emissions; build their capacity to trade emissions allowances domestically and internationally; and signal the need to factor the cost of greenhouse gas 	<p>Agreed that national policies need to be set consistent with countries we trade and compete with.</p> <p>New Zealand needs to monitor what our trading partners and competitors are doing to validate this assumption</p> <p>Agreed</p> <p>Agreed; although this is just a matter of ensuring transaction costs are efficient. That is a subset of the more important issue of whether the total policy response is the most efficient.</p> <p>Recommend keeping an open mind to an international C charge as also a possible option</p> <p>Agree with principle of consistency. Disagree that in the transition to post-2012 that differential treatment for different sectors will be more efficient than transitional broad based measures.</p> <p>This should apply to all sectors of the economy, ie both large and small emitters.</p>
--	--	---

	<p>emissions into future investments.</p> <ul style="list-style-type: none">• Prior to the introduction of broad price-based measures, mitigation measures for major emitters should encourage low-emitting or carbon neutral investment and avoid perverse incentives to delay emission reduction activities.	<p>Disagree with this sectoral specific intervention policy in the transition. Broad based measures even in the transition are likely to be more efficient. Cost benefit analysis should be undertaken to test which of these hypothesis is more likely.</p>
--	--	--