

8 June 2018

Steven Bailey  
Inquiry Director  
The New Zealand Productivity Commission  
By email to [info@productivity.govt.nz](mailto:info@productivity.govt.nz)

Dear Steven

**Low-emissions economy – Draft report**

1. This is a submission by the Major Electricity Users' Group (MEUG) on the draft report by the New Zealand Productivity Commission "Low-emissions economy, Draft report" published 27<sup>th</sup> April 2018 (the "Draft report").<sup>1</sup>
2. MEUG members have been consulted in the preparation of this submission. This submission is not confidential. Several MEUG members are making submissions on aspects directly affecting their business. This submission focuses on:
  - a) Possible future direct effects on electricity prices and security of supply; and
  - b) Maintaining best practice policy analysis and implementation.
3. The above 2-topics are covered in sections starting pages 2 and 3 respectively. This submission starts below with a section on acknowledgements and then matters of context.

**Acknowledgements**

4. MEUG members appreciate the opportunity to meet and discuss with Commissioner Dr Graham Scott and Commission staff Geoff Lewis and Ron Crawford on 23<sup>rd</sup> May including written responses to some initial questions tabled prior to the meeting.

**Important context matters for this submission**

5. MEUG's prior submission on 2<sup>nd</sup> October 2017 to the Commission on the issues paper provided background on the scale of MEUG members' contribution to GDP and employment and necessity for an emissions regime that does not lead to "carbon-leakage."<sup>2</sup> We don't repeat those points apart from reiterating they remain important context for policy makers.

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<sup>1</sup> URL [https://www.productivity.govt.nz/sites/default/files/Productivity%20Commission\\_Low-emissions%20economy\\_Draft%20report\\_FINAL%20WEB%20VERSION.pdf](https://www.productivity.govt.nz/sites/default/files/Productivity%20Commission_Low-emissions%20economy_Draft%20report_FINAL%20WEB%20VERSION.pdf) at <https://www.productivity.govt.nz/inquiry-content/3254?stage=3>

<sup>2</sup> <http://www.meug.co.nz/node/879>

6. Open and frank engagement, robust debate to test ideas and making decisions with limited information including back-up strategies should the future unfold differently is the world of commerce MEUG members and other productive sectors of the economy work in every day. We believe the Commission understands this and the need to apply similar approaches to policy development. More so for the economic, social and workplace transitions, scientific, technological innovations and international negotiating complexities expected over several decades as New Zealand and the world manage greenhouse gas (GHG) emission effects. One thing is for sure, the future will not be the same, and may differ considerably, from even an expected consensus scenario. An important take-out from the Draft report is to ensure future policy makers adopt a similar eyes-wide-open approach to assessing risks and opportunities and evolving strategies over time.
7. The final important matter of context for this submission is the 12<sup>th</sup> April 2018 announcements by the Prime Minister that ““There will be no further offshore oil and gas exploration permits granted.”<sup>3</sup> In this submission we refer to this announcement as the “12<sup>th</sup> April 2018 announced ban on new offshore exploration permits.” MEUG notes the assessment by officials that the announcement will have many harmful effects including increasing global emissions.<sup>4</sup> The announcement has raised many important questions relevant to the Draft reports 4-pillars necessary to have a “Stable and credible climate policy” (see diagram in paragraph 16 below).

#### **Possible future direct effects on electricity prices and security of supply**

8. MEUG welcomes the detailed analysis in the Draft report and supporting report for the Commission by Sapere<sup>5</sup> and supports the outcome of that analysis leading to recommendation R12.2:

“The Government should rely on an effective emissions-pricing system as the main instrument to achieve an efficient trade-off between emissions reductions in electricity and emissions reductions in other parts of the economy. The Government should be cautious in specifying targets for emissions within the electricity sector, and make sure that technology is available to meet them without significantly increasing wholesale electricity prices above the levels achieved with current technology.”

9. The caution proposed in recommendation R12.2 is amplified by the 12<sup>th</sup> April 2018 announced ban on new offshore exploration permits because evidence since that date indicates the ban could result in a shortage of gas by 2025, that is as early as 7-years-time, and certainly well before 2050.<sup>6</sup>
10. MEUG also supports recommendation R12.1:

“Given rapid changes in electricity-generation technology and potential effects of rising electricity prices on adoption of low-emissions technology in other parts of the economy, the Government should not use subsidies or regulation to favour particular technologies that generate low-emissions electricity.”

<sup>3</sup> <https://www.beehive.govt.nz/release/planning-future-no-new-offshore-oil-and-gas-exploration-permits>

<sup>4</sup> Refer the package of material published on 5<sup>th</sup> June 2018 by Hon Dr Megan Woods in response to multiple Official Information Act requests on the 12<sup>th</sup> April 2018 announced ban on new offshore exploration permits, <https://www.beehive.govt.nz/feature/block-offer-2018-release-information>

<sup>5</sup> One aspect of the Sapere report not agreed by MEUG is the proposal for a capacity market, refer s. 8.2.7, pp131-32, [https://www.productivity.govt.nz/sites/default/files/Transitioning%20to%20zero%20net%20emissions%20by%202050\\_Sapere.pdf](https://www.productivity.govt.nz/sites/default/files/Transitioning%20to%20zero%20net%20emissions%20by%202050_Sapere.pdf)

<sup>6</sup> Refer PEPANZ slides appended to the presentation to the Prime Minister and Ministers Woods and Little, 25<sup>th</sup> May 2018, <http://www.pepanz.com/dmsdocument/78> , slides 7 to 14.

11. The same logic should apply to the demand side where fast changing technologies make it risky for government to pick best near-term and longer-term light and heavy vehicle transport options. For example, conventional gasoline and diesel engine efficiencies have been and may continue to improve rapidly like EV's and other technologies. An optimal approach may be to continue renewal of most of the vehicle fleet in the near-term with conventional but more efficient engines and let consumers choose when to adopt EV's and other technologies when, as predicted, capital costs decrease. Accordingly, MEUG is not convinced by the claimed need for interventions, relative distribution of benefits relative to distribution of costs for different consumers and efficacy of recommendations R11.2, R11.3 and R11.4 proposing a feebate scheme for imported vehicles, financial support for EV charging infrastructure and government agency's purchasing EV's respectively. The recommendations R11.2, R11.3 and R11.4 supporting specific interventions MEUG suggests are better characterised as proposals worth further investigation given the model outputs are not sufficiently specified to allow a conventional NPV analysis as required by a Regulatory Impact Assessment. We discuss constraints on having monetised values for the models used later in paragraph 15.
12. MEUG supports recommendations R12.3 and R12.4 in relation to the Electricity Authority continuing its work on facilitating distributed energy resources (DER) and demand response (DR), and electricity distribution pricing and quality to meet the preferences of end-use customers. MEUG notes the government's decision to decline a proposed future-year programme for implementing Real-Time-Pricing (RTP) in the budget announced 17<sup>th</sup> April 2018 was a backward step for realising DR opportunities. The forgone expected NPV of RTP being in place is \$53 million.<sup>7</sup> We will be working with government to understand why this proposed levy appropriation was declined and how it can be reinstated for future years. The RTP appropriation decision reinforces concerns discussed later in relation to lack of effective consultation before key decisions are made such as the 12<sup>th</sup> April 2018 announced ban on new offshore exploration permits.

#### **Maintaining best practice policy analysis and implementation**

13. This inquiry has several exogenous constraints and a narrow set of output measures that lead to the analysis and findings being an initial rather than comprehensive analysis of risks and opportunities given the complexities listed in paragraph 6 above.
14. The exogeneous constraints include excluding uncertainties on the science, an assumption no effective inter-country emissions trading will be in place before 2050 and no risk assessment that other countries may materially fail to achieve the Paris Agreement target to have zero emissions between 2050 and 2100. Some, but not all, will be considered in further modelling by the Commission before publishing the final report.<sup>8</sup>
15. The output measures focus on emission volume trajectories over time and indicative emission prices to achieve pre-defined targets without considering effects on GDP and well-being. Comparisons of alternative scenarios and strategies require a common metric for measuring benefits and costs over time. Best practice requires benefits and costs to be monetised and flows over time discounted to estimate Net Present Values (NPV).<sup>9</sup> The Commission has advised MEUG that:<sup>10</sup>

<sup>7</sup> Electricity Authority, consultation paper, Real-time pricing proposal, 1<sup>st</sup> August 2017, p iv and paragraphs 4.12 to 4.22, URL <https://www.ea.govt.nz/dmsdocument/22389> at <https://www.ea.govt.nz/development/work-programme/pricing-cost-allocation/spot-market-settlement-on-real-time-pricing/consultations/#c16609> .

<sup>8</sup> Refer Draft report, p73.

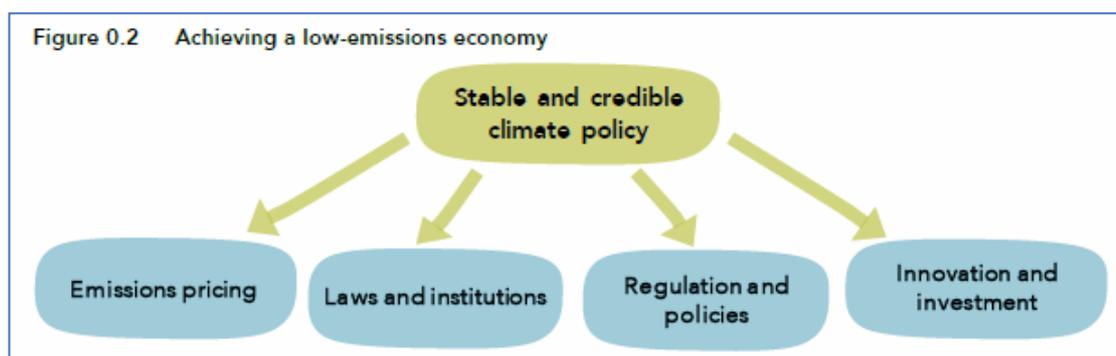
<sup>9</sup> Some benefits and costs are difficult to monetise in which case a range of feasible values can test if an analysis is robust or if further research is required to estimate dollar values for qualitative effects.

<sup>10</sup> MEUG and Productivity Commission, Written Q&A #6, 23 May 2018.

“The second stage of modelling will not include estimates of impacts on GDP/head because the model is not set up to do this. However, each scenario/pathway will have a dashboard of indicators of key outcomes.

The Minister for the Environment has commissioned other modelling (using a Computable General Equilibrium model) that will generate estimates of GDP/head in various transition scenarios. We understand that the results from this modelling will be made available at some point.”

16. The preceding paragraphs are not a criticism of the Draft report and findings, rather it illustrates why we think the Draft report is a good initial piece of work that the Commission and other policy makers can build on in the future. The most important finding in the Draft report for MEUG is the integrated framework that needs to be applied in ongoing development and implementation to achieve a low-emissions economy with the 4-pillars as illustrated in Figure 02 as replicated below:



17. In discussions and the written questions and answers as part of those discussions with the Commission we welcome a common view that:

“Best practice includes publishing all models and data used in its inquiry reports. It (the Commission) will endeavour to follow best practice and only withhold data or other information for good reasons (eg for substantive privacy, commercial-in-confidence or intellectual property concerns)”<sup>11</sup>

We will be expecting other advisors in the future, such as the Interim Climate Change Committee, MfE, Treasury, MBIE and the future proposed Climate Change Commission to adopt the same transparent approach to accessing models and data sources to allow interested parties to interrogate analysis underpinning proposed actions. There is a risk that Regulatory Impact Assessments (RIA) may not always be robust and independent because officials may be reluctant to be critical of Ministers pre-determined preferences in case that undermines their relationship to give ongoing advice.<sup>12</sup> Hence the importance of analysis and advice by specialist agencies such as the Productivity Commission, the proposed Climate Change Commission and departments, being transparent and capable of being tested by interested parties.

<sup>11</sup> Ibid, Q&A #1.

<sup>12</sup> This is a possible risk rather than a risk we can confidently demonstrate with an analysis of RIA to date. It is worth noting officials advice to Ministers on the 12<sup>th</sup> April 2018 announced ban on new offshore exploration permits, to the extent Ministers sought that before the announcement, was open, frank and robust, refer <https://www.beehive.govt.nz/feature/block-offer-2018-release-information>.

18. Governments campaign on policies in elections and once voted-in have a political mandate to implement those knowing that every 3-years voter's might change their views. Those election manifesto policies "that will ultimately require creating, amending, or repealing Acts" must have, according to the Cabinet Manual, a RIA.<sup>13</sup> Setting aside implementation of major election manifesto policies, of concern to MEUG is:
- a) Where a new incoming government announces soon after coming into office, major policy announcements that will have a material impact on the economy, require legislative change, were not part of the incoming governments election manifesto, were not consulted on and had no comprehensive advice from officials. The 12<sup>th</sup> April 2018 announced ban on new offshore exploration permits is an example of such an announcement.<sup>14</sup> The Commission needs to consider two aspects to that announcement in relation to achieving a low-emissions economy:
- First, are the current laws and institutions or regulation and policies pillars of the framework sufficient to mitigate harm from politicians grandstanding or making symbolic actions that have no or even harmful effects on achieving a low-emissions economy? and
  - Second, because the 12<sup>th</sup> April 2018 announced ban on new offshore exploration permits will materially change gas supply and demand profiles compared to those forecast in the Draft report as discussed in paragraph 9 above, eg a gas shortage may commence as early as 2025, then the 6-scenarios modelled in the Draft report either:
    - Need to be repeated with the revised gas supply and demand scenarios; or
    - New scenarios added to the analysis to consider the 12<sup>th</sup> April 2018 announced ban on new offshore exploration permits.
- b) Policy decisions at a more granular level that lack transparency. As mentioned in paragraph 12 above, an example of a material decision relevant to achieving a low-emissions economy is the recent decision not to approve future years RTP investment. This may be a more generic government accountability issue of trade-offs and decisions underpinning government budget setting processes being transparent and the quality of RIA as already mentioned. Nevertheless, it is a real-world and high NPV project relevant to advancing New Zealand towards a low emissions economy and therefore a good test case the Commission might consider analysing in the final report.

Yours sincerely



Ralph Matthes  
Executive Director

<sup>13</sup> Cabinet Manual, section 5.75 titled "Impact analysis for regulatory proposal", <https://www.dPMC.govt.nz/sites/default/files/2017-06/cabinet-manual-2017.pdf>

<sup>14</sup> Supporting evidence that the 12<sup>th</sup> April 2018 announced ban on new offshore exploration permits is an example with these features is set out in the package of material published on 5<sup>th</sup> June 2018 by Hon Dr Megan Woods in response to multiple Official Information Act requests, <https://www.beehive.govt.nz/feature/block-offer-2018-release-information>