

Submission to Government¹
on the
Suite of Energy and Climate Change Papers released in December 2006
from
The New Zealand Chambers of Commerce (Inc)
March 2007

Introduction

The New Zealand Chambers of Commerce (Inc), NZCCI, is an umbrella organisation serving the interests of 34 Chambers of Commerce nationwide. These, in turn, represent over 24,000 businesses around the country. While many of our members are in the SME category our membership includes most of the largest corporations in New Zealand.

This submission is in response to the suite of energy and climate change papers released by the Government in December 2006, namely:

1. Powering Our Future – Towards a Sustainable Low Emissions Energy System - The Draft New Zealand Energy Strategy to 2050, (*NZES*)
2. Discussion Paper on Measures to Reduce Greenhouse Gas Emissions in New Zealand Post-2012, (*Greenhouse Gas Emissions*)
3. 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, (*Transitional Measures*)
4. The New Zealand Energy Efficiency and Conservation Strategy - Making It Happen: Action Plan to Maximise Energy Efficiency and Renewable Energy in New Zealand. (*NZEECS*) and
5. Sustainable Land Management and Climate Change.

NZCCI welcomes the work done by Government in these areas and for the opportunity to submit on these important papers. However, we are concerned that:

- all these papers have come out at essentially the same time and that they have the same deadline for submissions;
- solutions are canvassed without rigorous or any cost benefit calculations having taken place;
- New Zealand appears to be contemplating action on regulation or trading mechanisms ahead of an international agreement being achieved on these;
- implications for the wider economy do not play a larger role in these discussion documents;
- subsequent to the release of these discussion documents, the government has announced significant new policy commitment to New Zealand becoming carbon neutral, again without a cost benefit analysis.

¹ The Ministry of Economic Development, Ministry for the Environment and the Energy Efficiency and Conservation Authority

NZCCI believes that it is imperative that a global consensus be achieved on how emissions are to be reduced, and that New Zealand policy should not be finalised until the time when such a consensus is achieved. Because of the impact on New Zealand's international competitiveness, NZCCI would not support the introduction of a greenhouse gas charge or emissions trading ahead of such action from our trading partners.

This does not mean that NZCCI is suggesting inaction. Far from it. We believe that business and Government should be working even more closely in this area (and should be expanding activities such as the workshops being run between the Wellington Regional Chamber of Commerce and the Ministry for the Environment on sustainable business practices.) We support increased investment in education and research, and the immediate application of technology where this is available. We also think that New Zealand should move fast to join the AP6 process.

Most of NZCCI's focus has been on The New Zealand Energy Strategy (NZES), Greenhouse Gas Emissions, Transitional Measures and NZEECS documents. Our comments on each of these are included in this submission. A summary of our overall position follows.

Overview

NZCCI is strongly supportive of sound international measures to address the risk of climate change by reducing global greenhouse gas emissions.

New Zealand has to do its bit on this critical issue, but measures must recognise that with only 0.2% of global emissions, New Zealand is too small for its actions to have any significant impact on total emissions. While leading the way has some benefits in terms of international kudos, the New Zealand economy must not be jeopardised for this benefit alone. Consequently, New Zealand must take care before taking any unilateral action to reduce greenhouse gas emissions or moving ahead of our trading partners.

Higher energy costs resulting from climate change policies would be detrimental to New Zealand's international competitiveness if our trading partners did not face the same measures. If economic activity shifted offshore in response to higher domestic costs of production and distribution it would be bad for our economy - yet importantly, global emissions would not be reduced at all. In fact global emissions might *increase* if emissions-producing economic activity were to shift from New Zealand to an economy with more lenient climate change policies. For this reason particular care needs to be taken on any transitional, pre-2012 decisions for the stationary energy sector.

In terms of the global policy response, we consider that price-based measures are better than regulation as a means of reducing emissions because of their use of incentives to producers and consumers to find the least-cost way to reduce greenhouse gas emissions.

Of the price-based measures discussed, we consider a greenhouse gas charge is likely to be more effective than emissions trading. Energy prices under a greenhouse gas charge would be more stable than they would under emissions trading.

A greenhouse gas charge would only be supported if it were accompanied by a corresponding reduction in income tax and matched by international action. It must

not result in an increase in the government's overall revenue. The economic gains from reductions in income tax would partly offset the costs associated with higher energy and transport prices.

A greenhouse gas charge should be broad-based. A broad-based greenhouse gas charge would ensure that all sectors pay according to how much they emit. Singling out sectors (eg electricity or transport) would put them at a disadvantage relative to other sectors in the New Zealand economy. This is one reason why we cannot support the singling out of the stationary energy sector as proposed in the Transitional Measures document and why we opposed the government's earlier proposal for a carbon tax that exempted agriculture and outlined special treatment for other major emitters. This essentially placed the tax burden on the service and SME sectors which were responsible for only a very small proportion of emissions.

Immediate action can still occur but it must be restricted to activities that do not impose excessive economic costs on New Zealand. For example, preparing for future policies by collecting data and increasing the capacity of major emitters to measure their emissions. Voluntary measures and encouraging innovation, investment in technological solutions and continued education are also important.

In summary, New Zealand cannot influence the rest of the world by moving ahead of the pack. New Zealand can achieve the most by participating fully in the international debate and encouraging other countries to take action but it should not take punitive action on itself unilaterally.

Notwithstanding the importance of climate change at this time and the contribution of the energy sector to this crucial global problem, we do not think other important energy issues have been given enough emphasis in the New Zealand Energy Strategy.

The NZES needs more of a social and economic context. It must recognise the tradeoffs between sustainable, low-emissions energy and other desirable social and economic characteristics.

The goal of moving to maximise the proportion of energy that comes from renewable energy resources is a very worthy one in principle. But there will be a point where use of renewables becomes undesirable even allowing for the positive externalities associated with renewables (reduced emissions etc).

The NZES also needs to acknowledge that a reduction in *international* greenhouse gases is the goal not just domestic ones. This means our marginal investment in greenhouse-gas mitigation must be tested against its international impact, not its domestic impact.

As with the NZES, the NZEEC also seems to place undue emphasis on reducing emissions (in both the targets and benefits) vis a vis the other benefits from energy efficiency and conservation.

There needs to be more use of cost benefit analysis throughout the documents. In the NZEECS, for example, no data is provided on the costs of the action plans and the benefits of these are yet to be determined in many cases.

Business organisations can make a contribution to improving energy efficiency and enhancing the uptake of renewables and NZCCI would be pleased to continue to work with the government to meet these goals.

1. Comments on the New Zealand Energy Strategy (NZES)

Climate change is the most important issue confronting the sector but not the only one

The main focus of the NZES is moving towards low emissions energy supply and facilitating a transition to greenhouse gas pricing.

We support these ideals in principle. However, notwithstanding the importance of climate change at this time and the contribution of the energy sector to this crucial global problem, we wonder if other important energy issues have been given sufficient attention in the strategy. These include the dominance of SOEs in electricity generation and the applicability of the SOE model for monopoly transmission, the impact of the Resource Management Act consent process on investment in the sector, and local generation versus transmission issues.

The NZES does address the important issues of energy security and affordability but we also consider these have not been given enough emphasis in the strategy relative to climate change.

These comments are not designed to understate the importance of climate change but to simply suggest more balance.

The Vision Needs a Social and Economic Context

The strategy's "vision" needs more of an international as well as a social and economic context. As it is worded, the vision offers no way of trading off the costs of sustainability and low emissions against anything else.

Changing the vision to "A reliable and resilient system delivering New Zealand sustainable, low emission energy **to meet our social and economic needs**" would allow the tradeoffs between what energy gives us, and what we might have to give up in its production, conversion and distribution to become more visible.

The lack of tradeoffs is apparent in the second part of the vision with the use of the word "maximizing" in the 2nd and 3rd bullet points. Without a context aspects of the energy system can be maximized without regard to anything else.

Cost Benefit Analysis

There needs to be more cost benefit analysis done on each of the proposed measures to achieve the strategy's vision.

For example, the goal of moving to maximise the proportion of energy that comes from renewable energy resources is a very worthy one in principle. But New Zealand should not sign up to an open book to increase the use of renewables. We want increased renewables only to the extent that it contributes to the kind of energy system we want (ie low emissions and contributing to the achievement of our social and economic needs).

There will be a point where use of renewables becomes undesirable even allowing for the positive externalities associated with renewables (reduced emissions etc). There needs to be a cost benefit analysis so we know where that point is before we can support such a proposal.

International Context

Climate change is an international problem and so the strategy needs more of an international context. It needs to acknowledge that a reduction in *international* greenhouse gases is the goal not just domestic ones. For example, it is possible New Zealand could have a significant impact on the global challenge of climate change through the researching and export of technology. Accordingly the strategy would be self-defeating if it restricted itself to reduction of New Zealand emissions only.

Furthermore it might make sense for New Zealand to increase its output of goods that are cleaner than those that can be produced elsewhere even if we increase emissions in the process. In other words, our marginal investment in greenhouse-gas mitigation must be tested against its international impact, not its domestic impact. (An analogy is Avian flu, where we might put our best resources at the international effort to deal with the problem, and domestically try and manage the risks for our own population.)

The “Sustainable technologies and innovation” section suffers from this problem in that it is written as though New Zealand R&D should be judged against the potential contribution to New Zealand’s energy needs, not its wider economic and social needs. Hence we end up with all the high priority R&D being virtually confined to areas where New Zealand has energy resource endowments. There is no attempt in table 6.1 to address areas where New Zealand could:

- have significant impact on the global problem of climate change through science
- engage in commercially lucrative exporting of technology, even though there is little impact on our own energy needs
- reduce our energy content in key exports.

Discount Rate

We note that the 10% discount rate that has been used in the past is to be replaced by a 5% discount rate. This would make proposals more attractive than they would otherwise be.

We are not sure of the rationale for the lower rate but we are keen to engage in debate with the government on this. It is important that we have a consistency of approach in discount rates across government. We note that 10% remains the preferred rate when decisions are made on transport infrastructure. We note also that in the UK, Australia and elsewhere rates of 3.5% are suggested as appropriate.

The controversy generated by the 0.1% discount rate suggested in the Stern Review should also be noted.

Other Comments on the Vision

“Maximizing how efficiently we use our energy to safeguard affordability, economic productivity and our environment”

- Efficient use of energy does not necessarily “safeguard” these things.

- Economic productivity is not the only economic interest in energy. There is nothing about maintaining (or even growing) economic output.
- We want to increase economic efficiency through the more efficient use of energy rather than the other way around.

“Maintaining high levels of security and reliability at competitive prices”

- Security of supply is important but it comes at a cost reflected in the price consumers pay. There will be a point where too much security is too expensive. Consumers should be able to choose the level of security and reliability and pay for it.

“Promoting environmentally sustainable technologies”

- Why not *all* sustainable technologies?

2. Comments on the *Greenhouse Gas Emissions Document*

NZCCI is strongly supportive of sound international measures to address the risk of climate change by reducing greenhouse gas emissions.

New Zealand Must Keep in Step with Trade Partners

With only 0.2% of global emissions, New Zealand is too small for its actions to have any significant impact on global emissions but it is imperative that New Zealand does its bit on this crucial global issue. Lagging behind other countries would seriously damage New Zealand's reputation as a responsible international citizen (as well as harm its clean, green image etc). However, New Zealand must take care before taking any unilateral action to reduce greenhouse gas emissions or moving ahead of our trading partners.

Government imposed regulation of energy supply or price-based measures that raise energy and transport costs would be detrimental to New Zealand's international competitiveness if our trading partners did not face the same measures. If economic activity responsible for emissions shifted offshore in response to higher domestic costs it would be harmful to our economy yet importantly, global emissions would not be reduced at all. In fact global emissions might increase if that economic activity were to shift to another economy with more lenient climate change policies.

Short-term Actions

Unilateral action must be restricted to activities that do not impose excessive economic costs on New Zealand or impact in any way on New Zealand's international competitiveness. This does not mean inaction. There is a great deal that can be done in the short term including preparation for the implementation of future greenhouse gas charge or emissions trading programs.

This includes acting now to increase the capacity of major emitters to measure their emissions, collecting data etc in preparation/ readiness for price-based measures. Voluntary measures and supporting policies such as providing information, encouraging innovation and continued education are also important.

Some New Zealand companies can and are benefiting from moves to decreasing emissions and there are likely to be opportunities arising from the government's measures to address climate change. Notwithstanding this, the costs to the overall economy are likely to be significant if our international competitiveness is reduced and the benefits from any associated reduction in income taxes are not able to compensate.

Price-based Measures are better than Regulation

We note the government's positive view on the use of economically efficient price-based measures (economic instruments) applied broadly across key sectors of the economy. NZCCI is also of the view that price based measures are better than directive regulation.

The price-based measures considered in the document include greenhouse gas charges and emissions trading (discussed in more detail later in this submission.) Price-based measures are better than regulation because of their use of incentives which is more efficient. Regulation is a blunt instrument that can create a range of

unintended distortions. Price-based measures permit flexibility in achieving emissions reductions whereas regulation does not.

Price-based measures integrate the overall costs of greenhouse gas emissions into the decision making of market participants. This provides incentives to producers and consumers to find the least-cost way to reduce greenhouse gas emissions. For example, making energy suppliers face a cost of greenhouse gas emissions will act as an incentive for them to shift toward renewables generation and/or develop technologies that reduce or emissions. Higher energy prices will incentivise businesses and consumers will look to reduce consumption of emissions producing energy and/or invest in more energy-efficient technologies and in alternative fuels.

While price-based measures are preferable to regulation, it is acknowledged that they may work better in some sectors than others and so a mix of measures to operate alongside price-based measures may be necessary.

We are open to the idea of Emissions Reduction Agreements (ERAs) as an accompanying measure. These would have to be voluntary as mandatory measures would not be flexible enough to work effectively and would disadvantage industry without due regard to the benefit from emissions reductions. Such voluntary agreements would be a useful support to a price-based measure.

Price-based measures would create incentives for companies to encourage fuel switching to renewables. We would not favour subsidies to further encourage such switching. Subsidies would advantage one sector over others. They would have to be paid for by way of higher taxes or government expenditure foregone elsewhere. Price-based measures would be futile if emitters paid a higher price but received it back by way of subsidies unless those subsidies were clearly decoupled from emissions producing activity.

Greenhouse Gas Charge vs Emissions Trading

Of the price-based measures discussed in the documents we consider a greenhouse gas charge is likely to be more effective than emissions trading.

Energy prices under a greenhouse gas charge would be more stable than they would under emissions trading. Price certainty is important for business for planning and investment purposes. Emissions trading would produce much greater volatility in energy prices and would be more complex to administer. The document suggests that emissions trading is more likely to achieve a reduction in emissions but we note that the European emissions trading scheme (ETS) has not worked well and that carbon emissions actually increased in 2005 under this scheme.

Greenhouse gas charges would be transparent and would enable scrutiny from the media and political process whereas emissions trading would be complex and less transparent. Greenhouse gas charges would impact on emitters depending on how much they emit. Under emissions trading it would be difficult to differentiate between the impact of the emissions market or other factors when scrutinising energy price movements.

New Zealand is too small to establish a local market. But entry into a global emissions trading scheme may be appropriate. This could coexist with a greenhouse gas charge which should be the major instrument.

A Greenhouse Gas Charge

A greenhouse gas charge would only be supported if it were matched by international action of similar effect and if accompanied by a corresponding reduction in income tax. It must not result in an increase in the government's overall revenue ie the net effect must be fiscally neutral.

Revenue should be recycled to general Crown revenue (just as road and other excise taxes generally are). Lower income tax would improve New Zealand's international competitiveness and boost investment, employment, productivity and economic growth. The economic gains from reductions in income tax would partly offset the costs associated with higher energy and transport prices.

Because of the effect on energy prices, a greenhouse gas charge with corresponding income tax reductions would represent a transfer from energy consumers (including transport) to taxpayers. Consequently, there are some transitional issues that might need to be addressed.

A greenhouse gas charge should be broad-based. Singling out sectors (such as electricity or transport) would put them at a disadvantage relative to other sectors in the New Zealand economy. A broad-based greenhouse gas charge would ensure that sectors pay according to how much they emit.

New Zealand must not introduce Price-Based Measures ahead of our Trading Partners

Because of the impact on New Zealand's international competitiveness, NZCCI would not support the introduction of a greenhouse gas charge or emissions trading ahead of such action from our trading partners.

New Zealand's climate change response must be aligned with what our major trading partners are doing. We are pleased to note that the *Greenhouse Gas Emissions* document acknowledges this when it says; "the policy must recognise the international context of actions taken in New Zealand, including the need for the world's major emitters to take effective action. The government believes the pace and stringency of New Zealand's response to climate change should be aligned with our national interest and in step with what major emitters – including our major trading partners – are doing."

In summary, New Zealand cannot influence rest of the world by moving ahead of the pack. New Zealand can achieve the most by participating fully in the international debate and encouraging other countries to take action but it should not take punitive action on itself unilaterally.

An Early Decision would Provide Certainty

Notwithstanding the uncertainty around the international environment and what our future obligations will be, there needs to be as much certainty as possible for investment and business planning. This means an early decision as far as possible as to what steps New Zealand intends to take is desirable. Such a decision should encompass the type of measures to be imposed and when they would commence (remembering that we cannot afford to move before our trading partners.)

3. Comments on the *Transitional Measures Document*

The Transitional Measures document deals with potential measures that can be adopted in the short term ie prior to 2012, focussing on the period 2007-2015, for the stationary energy sector (ie non-transport sectors) only.

We are opposed to the introduction of such measures on this sector on the grounds that they would be unilateral, narrow-based and ineffective in terms of impacting significantly on New Zealand's emissions (let alone the world's.)

Unilateral

As mentioned in our comments on the Greenhouse Gas Emissions document, global climate change needs to be addressed urgently but New Zealand needs to be careful about acting unilaterally. For this reason care needs to be taken on any transitional pre-2012 decisions for the stationary energy sector.

NZCCI cannot support a greenhouse gas charge or emissions trading or any other mechanism that erodes New Zealand's international competitiveness. If other countries were to adopt such a measure in this period, then this situation could be reassessed.

Transitional measures which can be supported include preparing for the implementation of future greenhouse gas charge or emissions trading programs. For example, acting now to increase the capacity of major emitters to measure their emissions and collecting data etc in preparation for price-based measures. Voluntary measures and supporting policies such as providing information, encouraging innovation, investing in technological solutions, and continued education are also important.

Narrow-based

In addition to the timing factor, we cannot support the singling out of the stationary energy sector. We strongly endorse the principle, stated throughout the documents, that any price-based measures should be broad-based. The narrow-based objectives of *Transitional Measures* are both inefficient and inequitable. Singling out the stationary energy sector would put it at a disadvantage relative to other sectors in the New Zealand economy.

We note the recent analysis of LECG² which shows that the introduction of a narrow-based emissions trading scheme of the electricity generation sector in New Zealand is likely to introduce significant costs to electricity consumers, with little consequential reduction in emissions. This result is likely to apply to other price-based measures applying only to this sector.

These estimates do not include the potential flow-on effects to the competitiveness of exporting firms.

The relatively low contribution of electricity generation emissions to total greenhouse gas emissions in New Zealand means that New Zealand's total emissions would not be significantly reduced with the introduction of such a narrow-based proposal.

² Costs to Consumers of a Narrow Based Emissions Trading Scheme in the New Zealand Electricity Market, March 2007

4. Comments on the New Zealand Energy Efficiency and Conservation Strategy (NZECS)

While the NZES deals with energy supply, the NZEECs deals with issues relating to energy demand, focussing on the conservation and renewable energy objectives of the NZES. We strongly support these objectives in principle but consideration needs to be given to cost. Energy efficiency and conservation makes business sense and adopted by businesses where it is cost effective to do so.

More Use of Cost Benefit Analysis

The action plans appear effective ways to meet the efficiency and conservation objectives but no data is provided on the costs of such plans and the benefits are yet to be determined in many cases. There needs to be more use of cost benefit analysis and hard data to ensure that the cost of such actions does not outweigh the benefits.

Where the benefits have been quantified, more information needs to be provided showing where the benefits fall (ie businesses/consumers or public). We acknowledge that many of the benefits will be “external” (eg associated with emissions reductions, health benefits etc) as well as cost savings for consumers of energy and that the former should also be incorporated in any cost benefit analysis.

Climate Change is not the Only Energy Conservation Issue

Emissions reduction is one of the more important benefits of energy efficiency and conservation. It is especially important at this crucial time but it is not the only public benefit. Other environmental benefits relate to water use, mining, use of finite resources, pollution from non-greenhouse gases and visual pollution etc.

Sometimes the document seems to place undue emphasis on reducing emissions (in both the targets and benefits) vis a vis the other benefits from energy efficiency and conservation (internal and external). For example it tends to bundle the other benefits together as “energy savings” (or ignore them altogether) with “greenhouse gas savings” separated out as a separate benefit.

There will be occasions where increased energy efficiency (and associated benefits) is not aligned with decreasing emissions. Ie the most energy efficient course of action may result in more emissions than the alternatives.

Other Issues

A combination of technology, and energy conserving behaviour can best achieve reduced energy use. It makes financial sense for businesses and consumers to conserve energy and they can and will do so. Education as to when and how savings can be made is important. Energy conservation should not be imposed compulsorily though.

Meeting the strategy’s efficiency and conservation goals requires a mix of improving technical efficiency as well as influencing New Zealanders’ energy purchasing and usage behaviour. The strategy has the balance between these two approaches about right.

The use of targets in the strategy is a sensible approach. Targets only make sense if there is a plan of action and parties are accountable for achieving them. Targets should set the direction and intensity of change and while it is appropriate to set ambitious targets, the public won't buy into them if they are unrealistic. Compulsory targets should not be imposed on businesses or consumers.

Limited targets are currently proposed for the transport sector particularly public transport. Each region's Land Transport Strategy (as required under the Land Transport Act) could be made use of to develop these targets.

There is insufficient detail regarding some of the measures to establish minimum standards, product labelling and performance rating as set out on page 61. Businesses should not be required to fund such schemes or bear the associated compliance costs. We favour the use of education, voluntary measures and incentives ahead of mandatory measures with regard to the measures discussed in this section.

Business organisations can make a contribution to improving energy efficiency and enhancing the uptake of renewables and NZCCI would be pleased to continue to work with the government to meet these goals. Expanding activities such as the workshops being run between the Wellington Regional Chamber of Commerce and the Ministry for the Environment on sustainable business practices is one way to do this.