

Submission by



to the

Climate Change Commission

on the

Draft first package of advice to the Government

March 2021

1.0 INTRODUCTION

1.1 ExportNZ welcomes the opportunity to comment on the Climate Change Commission's draft emissions budgets as presented in its 31 January Draft Advice for Consultation. ExportNZ supports the BusinessNZ/Business Energy Council submission but would like to highlight some key areas of impact for the export sector.

1.2 As with BusinessNZ, we welcome the Commission's Draft Advice for Consultation outlining the direction of policy necessary for New Zealand to reduce greenhouse gas emissions quickly, significantly, and permanently. The Commission recognises that is not an insignificant challenge and has worked through a wide range of issues in a methodical, deliberate way, and should be congratulated for its thoughtful assessment of the issues it has undertaken.

1.3 New Zealand needs to do its bit to combat Climate Change. It is our duty to address these issues for the sake of the climate, for future generations and to ensure our global reputation is upheld amongst our trading partners. Part of staying globally competitive is ensuring industry in New Zealand maintains their social license to operate. For exporters who want to sell their products abroad, positioning New Zealand as a country of environmental stewards will be crucial, particularly given our geographic distance from markets. ExportNZ supports an approach to emission reductions that gives business a clear direction of travel in the years to come. Clear direction of travel will also provide businesses with the confidence needed to invest in new lower emission technology.

2.0 MORE DETAILS ON COST IMPLICATION NEEDED.

2.1 The Climate Change Commissions Draft Consultation on carbon budgets covers a lot of the issues that makes decarbonisation of an economy such a difficult challenge. Despite the sectoral challenges being covered well at a big picture level, when it comes to solutions and implementation, more details around the costs associated are required to show the viability of these recommendations.

2.2 The Climate Change Commissions Draft for Consultation does not give us the level of detail we need to get this issue in front of small to medium sized exporters and manufacturers in New Zealand. We need to know what the various options mean in terms for costs for business. The costs are likely to flow through to business through various channels, such as cost of electricity, fuel and the cost of raw materials and goods particularly for companies who use energy intensive input products such as steel, aluminium, cement etc. The Commissions Draft

Advice does not provide that level of detail. Until we get that detail it is hard for us to properly engage small to medium size businesses and get their considered feedback.

2.3 We understand that changes to the Emissions Trading Scheme (ETS) will ensure the price of units will steadily increase and that free allocations to emission intensive trade exposed businesses will reduce. This paired with other policy recommendations around ending new gas connections early and introducing bioenergy mandates within 3 years are likely to result in significant cost added to doing business in New Zealand, particularly if the measures are ahead of affordable alternatives.

2.4 We are concerned that the Climate Change Commission modelling that estimates cost of the transition (less than 1% of projected GDP) is vastly different to the analysis done by NZIER for the Ministry for the Environment in 2019. The latter estimated real GDP dropping by an average of \$7.8 billion a year. It strikes us that trying to model impacts for 30 years into the future, based on assumptions, some of which are already incorrect (e.g., current electricity price and carbon price) is a somewhat ineffective exercise and the true cost is probably somewhere in between the two models. Both sets of modelling envisage carbon prices in the ETS as needing to be very high (NZIER averaging \$272/tCO₂e and Climate Change Commission \$250/tCO₂e by 2050) which compared to the current price of units in the ETS, at \$39/tCO₂e, is a huge difference. Some businesses that have to absorb these costs, will be unable to keep up with this increase, regardless of what policy interventions the Government pursues.

3.0 EMISSIONS LEAKAGE AND COMPETITIVENESS

3.1 The carbon price must be in line with the economy's ability to respond. If the carbon price does get ahead of the economy's ability to respond to the costs, there should be safety valves in place. The commission's key principle number 2 – Focus on Decarbonising the Economy – notes that New Zealand needs to decarbonise New Zealand's industries, rather than decrease production in a way that could lead to moving production to higher emission production offshore. ExportNZ is concerned about the risk of carbon leakage and our businesses being able to maintain their competitiveness internationally, particularly those firms that are energy intensive and trade exposed. New Zealand based energy intensive companies are typically much greener than their international competitors due to the high percentage of renewable energy in our electricity system. If these energy intensive industries such as steel, aluminium,

pulp and paper, cement etc., move offshore or close down, those products will be made somewhere else in a less climate friendly way.

3.2 If New Zealand exports its industry and associated emissions to other countries that are less efficient than we are – then the environment is worse off, and we have lost our major employers. These industries are amongst our biggest employers in terms of staff numbers, our highest payers and are very important to the business ecosystem. The latter is true due to the number of suppliers that supply them and for the products they produce which are used downstream in local supply chains. A concerted effort must be made to calibrate the speed and stringency of our actions with that taken by with our trade-competitors to ensure that New Zealand is taking a global role in decarbonisation, rather than moving the problem off-shore.

4.0 RESEARCH AND DEVELOPMENT

4.1 We support the Commission's call for accelerated and secured investment channels for R&D to meet the 2030 and 2050 targets. Research and Development will be a key enabler for both the development of technology that drives a low emissions economy, but also for understanding the sustainable models of farming, forestry and horticulture that will emerge. The Research Science and Innovation funding mechanism needs to support businesses to deliver on the advice. ExportNZ has had feedback from business that the new R&D tax incentive is not currently fit for purpose. Feedback is that the IRD and Callaghan Innovation are taking a very narrow interpretation on what qualifies as R&D, even for some of our biggest investors in R&D. All the emphasis has gone on research that is 'new to the world' and development has little support. The transaction cost of accessing the tax incentive is high, and most firms have to engage the 'big four' consultants to apply for tax relief. This needs urgent attention from the Government.

5.0 SAFETY VALVES IN THE SYSTEM

5.1 Given the risks to the economy if the transition does turn out to be high cost, it is concerning that the Climate Change Commission has ruled out some safety valves, for example access to international emission reduction credits that are authentic and validated emission reductions. Historically, emissions trading schemes were set up to find least cost emission reductions, and once the low hanging fruit has been secured you gradually move to

the higher cost emission reductions. As the cost increases, the lower emission technology hopefully becomes available and at more competitive prices. In an ideal world, we would have a globally connected emissions trading scheme with a common cost of carbon that increases over time. That has proven hard to achieve as countries have taken different approaches over the years. Article 6 of the Paris Agreement is about the many ways countries can cooperate to reduce emissions and increase climate change action. Examples include:

- bilateral or regional cooperation, including emissions trading schemes which link to each other or project-based mechanisms which could provide crediting to other countries,
- a specific mechanism established by the Paris Agreement (but which is not yet operational)

ExportNZ supports an international carbon market where any trade of emissions must have environmental integrity, be accounted for, and authorised by the countries involved.

6.0 SMOOTHING OUT ECONOMIC SHOCKS

6.1 It is the view of ExportNZ that we need to have clarity of the costs of the net zero carbon target and clear direction on how we are going to get there. The Government needs to be able to smooth out potential economic shocks to avoid untenable price increases to consumers and businesses. Failure to do so may lead to policy flip flops and a lack of public support. If we are to take the public and businesses on the journey, price increases need to be manageable and predictable. Maybe the solution is that as the cost of carbon emissions increase, the level of personal and or company tax decreases correspondingly – so we increase tax on environmental externalities – but we decrease taxes on things we want to encourage, like labour and business endeavour.

7.0 AGRI-SECTOR EMISSIONS

7.1 We support the Commission's separation of short and long-lived gases. It is important that policy incentivises biodiversity, and that we are not putting policies in place that incentivise farmers to retire good food production land into pine trees. We have had feedback that at the current ETS unit price \$39/tCO₂e it is twice as profitable to plant pine trees as it is to farm a sheep and beef farm. Once trees have been planted and are earning ETS units, future land use change is very hard to achieve, and that pine plantation becomes locked in. We note that

planting trees is one of the lowest cost emission reduction actions that can be taken, and as a result, the rest of the world will be planting trees as well. As such there will undoubtedly be an oversupply of trees in the future, which could lead to a collapse in prices and owners of plantations failing to maintain them, so ensuring there are adequate safety valves that will not allow this to happen will be critical. New Zealand is a leading producer of low emissions food vis-à-vis other countries and food makes up a significant percentage of our goods exports. Food exports have seen the New Zealand economy weather both the Global Financial Crisis and now Covid19, and while our economy is diversifying and will continue to diversify, food exports are an important global competitive advantage for New Zealand when it comes to our export earnings. Getting the incentives right for the correct mix of food production, biodiversity and carbon sinks will be critical for our economy and for our rural communities.

8.0 GOVERNMENT INTERVENTIONS

8.1 The goal of getting to net zero emissions by 2050 is one that many countries are signing up to, which is good as if others are taking similar steps at a similar cost, then our international competitiveness remains, and we don't lose businesses to other countries with few constraints around emissions. However, it strikes us that to fully embrace the emissions reductions proposed by the Climate Change Commission, there are a lot of things that central and local Government have to invest in and in a timely way in order to smooth the transition. For example, high quality public transport, bike path options, better rail options, EV charging infrastructure, rural broadband, and internet connectivity etc. Thought needs to be given as to how we bridge the gap between the cost of fossil fuel and biofuel, the cost gap between combustion engines and electric vehicles, the gap between the cost of a timber framed multi-storied buildings and steel and concrete building materials. What are the barriers to both business and consumers investing in distributed energy and how long will it take Government to remove them? If there are timing mismatches, then the alternatives become hard in more ways than just price. In addition, education into new technologies, safety standards and industry capability need to develop in parallel. There needs to be greater collaboration between central and local Government, business, and industry on ways to overcome these barriers. As a small example, we heard from a manufacturer that they wanted to put a solar array on the roof of their warehouse but were told by a council certifier that it would not get a building certificate due to the fact that if there was a fire, Firefighters could not safely get on the roof as even if the mains were switched off the unit would still be storing electricity. Another business has told us they will not have electric vehicles on their yards due to bad

experiences. One electrified a forklift when being moved and another exploded when being taken off a truck. This experience has given their company significant concerns about the safety of electric vehicles.

9.0 BORDER TAX ADJUSTMENTS

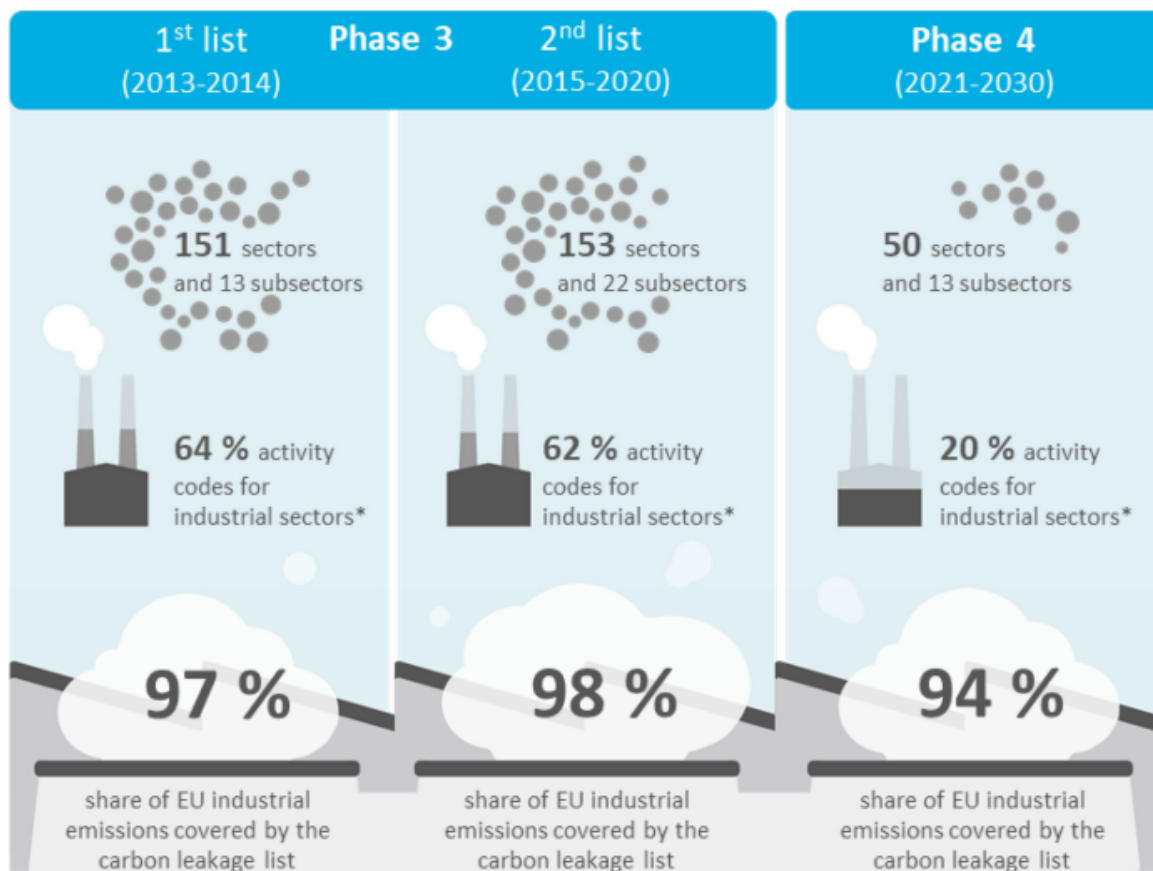
9.1 “As a small trading nation that has faced tariff and non-tariff barriers with many of our trading partners over the years, we would be very concerned that border carbon adjustments will become another form of trade barrier. Some of New Zealand’s largest trading partners including the EU and the US are advocating these sorts of measures to protect and assist their own producers who are already significantly subsidised. Given the complexity of every country’s approach to emission reductions, and the lack of mutual recognition for the approach to emissions reductions, it will be hard to compare apples with apples. For example, a report by the European Court of Auditors titled “The EU’s Emissions Trading System: free allocation of allowances needed better targeting” found that the European Union’s ETS carbon leakage list, which represents 94% of the EU’s industrial emissions, benefit from free allocation based on 100 % of the relevant benchmark. The excerpts below from the European Court of Auditors report highlight the complexity of comparing emissions reductions efforts between jurisdictions.

9.2 "For phase 4, and following Commission proposals, the share of industrial sectors considered at risk of carbon leakage was substantially reduced. But these sectors still represent 94 % of EU industrial emissions (see Figure 13). The carbon leakage list does not establish different degrees of carbon leakage risk for the various sectors included in it, treating all of them equally.



The EU ETS treats equally all sectors that are deemed to be at risk of carbon leakage. This means that all sectors included in the EU ETS carbon leakage list benefit from free allocation based on 100 % of the relevant benchmark. In comparison, the ETS systems in place in the US state of California and in the Canadian province of Québec adopt a carbon leakage list with sectors classified under high, medium, and low risk of carbon leakage.

Figure 13 – General information on EU ETS carbon leakage lists



* The percentage indicated refers to the number of industrial sectors in the Statistical Classification of Economic Activities in the European Community (NACE), and does not provide any information on industrial production or industry size.

Source: ECA, based on EU legislation and European Commission data.

Conclusions and recommendations

This audit concentrated on the role of free allocation of allowances within the EU ETS. Our main audit question was "Did decisions on free Emissions Trading System allowances provide a reasonable basis to encourage the reduction of greenhouse gas emissions?" We found that, despite good reasons for their use, better targeting of free allocation would have had multiple benefits for decarbonisation, public finances and the operation of the single market.

The Directive describes free allowances as a transitional method of allocating allowances in contrast to the default method (auctioning). However, for both phase 3 and 4 of the EU ETS, they continue to represent more than 40 % of the total number of available allowances.

Free allocation was provided to eight Member States where per capita GDP was below 60 % of the EU average, to support modernisation of their electricity production sectors. We note

that the legislative authorities improved the rules for free allocation of allowances to better promote real investment in the power sector (see paragraphs 22 to 24) for phase 4 of the EU ETS. We find that, collectively, the power sectors of the Member States providing these free allowances made significantly slower progress in decarbonisation. Investments made focused on improving power generation through coal.

We found that the number of free allowances allocated to the industry and aviation sectors in phase 3 was not based on their ability to pass through costs and that, while carbon leakage has the potential to affect EU carbon markets, and thus the evolution of the greenhouse gas emissions worldwide, there is limited targeting of the free allocation of allowances”.

We have included those excerpts from the report to highlight that while most countries are pursuing similar goals to decarbonise their economies, they are concerned about the competitiveness of their industries and are using free allocations of units to protect them against the full force of a carbon price. Given the range of different approaches and the complexity of emissions trading systems, it is hard to compare approaches. Therefore, if countries start to impose border carbon adjustments in a unilateral manner, this could be the beginning of a significant new rise in tariff barriers to trade in the 21st century. We would urge New Zealand to consider very carefully the broader risks of going down this path and to insist that any measures that are contemplated by our trading partners are elaborated multilaterally and take full account of WTO rules and principles.

10. SUMMARY

10.1 New Zealand needs to do its bit to combat Climate Change. It is our duty to address these issues for the sake of the climate, for future generations and to ensure our global reputation is upheld amongst our trading partners.

10.2 A greater level of detail is required to get this issue in front of small to medium sized exporters and manufacturers in New Zealand. We need to know what the various options mean in terms for costs for business.

10.3 The carbon price must be in line with the economy's ability to respond. If the carbon price does get ahead of the economy's ability to respond to the costs, there should be safety valves in place to avoid carbon leakage.

10.4 The Research, Science and Innovation landscape in New Zealand needs to support accelerated and secured investment channels for R&D to meet the 2030 and 2050 targets.

10.5 ExportNZ supports an international carbon market where any trade of emissions must have environmental integrity, be accounted for, and authorised by the countries involved.

10.6 We support the Commission's separation of short and long-lived gases. It is important that policy incentivises biodiversity, and that we are not putting policies in place that incentivise farmers to retire good food production land into pine trees. Getting the incentives right for the correct mix of food production, biodiversity and carbon sinks will be critical for our economy and for our rural communities.

10.7 Central and local Government have to invest in infrastructure in a timely way in order to smooth the transition, for example, high quality public transport, bike path options, better rail options, EV charging infrastructure, rural broadband, and internet connectivity etc.

10.8 Border tax adjustments will become another form of trade barrier for New Zealand. Given the complexity of every country's approach to emission reductions, and the lack of mutual recognition for the approach to emissions reductions, it will be hard to compare emissions reduction efforts between jurisdictions.

ABOUT EXPORTNZ

ExportNZ is a national industry association representing a diverse range of exporters throughout New Zealand. ExportNZ is a division of BusinessNZ, New Zealand's peak business advocacy body.

We are a membership organisation and across our two brands have approximately 2,000 export members. We also have four regional partners: Employers Manufacturers Association (Upper North Island), Business Central (Lower North Island), Canterbury Employers Chamber of Commerce (Upper South Island) and Otago Southland Employers Association (Lower South Island) which between them represents the bulk of manufacturers in New Zealand.

Our value proposition for members is a mixture of policy and advocacy, education and training, networking, trade missions and inspiration through awards events and conferences. Notably, we run a BusinessNZ Chief Technology Officers Group, incorporating the largest innovation-driven companies in New Zealand, many of which export.