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5 March 2010

Hon John Key
Prime Minister
C/O Parliament Buildings
Wellington

via e-mail: john.key@parliament.govt.nz

Dear Prime Minister

Emissions Trading Scheme and Climate Change Policy Settings

We wish to raise our growing concerns regarding the apparently widening disconnect between the international environment and the implementation of an all gases all sectors emissions trading scheme in New Zealand.

Recent events show that the international climate change context is less certain than previously anticipated. We think that the current emissions trading scheme is too rigid and may in fact frustrate the delivery of the outcomes sought from it. Therefore, we seek an assurance from you that in light of recent events the Government is taking stock of whether the current climate change policy settings which focus primarily on an emissions trading scheme remain appropriate for New Zealand.

To date the Government's position, which we support, has been that:

1. New Zealand's emissions trading scheme should be aligned with Australia's as far as possible; and

2. New Zealand should move in line with, but not ahead of, its trading partners.

We also support initiatives such as the global alliance on agricultural research.

However, the international environment has changed significantly over recent months and we are concerned that the emissions trading scheme is now inconsistent with these stated goals. Specifically:

1. there is no Australian scheme with which to align and it is not certain that Australia (or the USA) will adopt an emissions trading scheme;

2. the New Zealand scheme remains substantially more stringent than the EU ETS, in that ours is an all-sectors, all gases scheme;

3. other countries have not accepted binding emission reduction targets or set carbon prices;

4. there is serious doubt that New Zealand will be able to have recourse to a broad and efficient liquid international carbon market (one of the conditions of the Government's emission target);

5. carbon credits may be in short supply and available to New Zealand purchasers only at high prices. The prospect also remains that limits may be imposed on the importation of carbon credits; and

6. it is widely acknowledged that there is little prospect of substantial progress being made at the Mexico COP at the end of this year.

From 1 July this year, in spite of the transitional phase-in of obligations, businesses will face a cost of carbon that their trade competitors will not. This will place them at a competitive disadvantage. Carbon leakage and damage to New Zealand's international competitiveness are very real risks.

These risks are exacerbated by the combined prospect of continued global inaction and the scheduled removal of the scheme's moderating effects in 2012. In this environment the emissions trading scheme also fails to provide business with sufficient confidence in which to invest in emission abatement opportunities unless they have a short payback period. Beyond 2012 uncertainty is pervasive.

Doubts therefore exist as to the ability of the scheme to deliver on its purpose. The explanatory note to the Climate Change Response (Moderated Emissions Trading) Amendment Bill stated, amongst other things that its purpose was to:

> "● reduce competitiveness impacts of the NZ ETS and provide greater certainty for economic growth:
>
> ....
>
> ● maximise the degree of harmonisation with the Australian Carbon Pollution Reduction Scheme to reduce trans-Tasman competitiveness risks:"[1]

Section 3(1)(b) of the Act states that its purpose is, amongst other things:

> ".....a greenhouse gas emissions trading scheme......that supports and encourages global efforts to reduce greenhouse gas emissions...."

The doubts that there will be a successor international agreement in the near future and the absence of an Australian scheme now places the attainment of the stated purposes of the Act at risk. New Zealand's position is looking more and more like international leadership. We raised these issues with you and your Ministerial colleagues in a letter dated 13 November 2009.

Businesses are now being processed into an allocation framework that was intended to harmonise the degree of protection with that of their Australian counterparts. The heavy reliance on an Australian allocation framework designed for Australian industry was always likely to be problematic for carbon and energy efficient New Zealand

[1] Climate Change Response (Moderated Emissions Trading) Amendment Bill, Explanatory note, page 1

businesses (such as for food processors) but its absence and reliance on the New Zealand specific allocation framework is likely to prove no less so. This has immediate implications for business as its practical effect is to potentially discourage production from happening where it is most carbon and energy efficient. Small trade-exposed firms such as processors of wool, leather, wood panels, and fruit, manufacturers of lime, salt, bricks, and carpet yarn and meat renderers are also cases in point.

As a group, we have been wrestling with what the evolving international context means for business. One common theme emerges – a business-as-usual approach is no longer appropriate.

The Government's acknowledgement of the conditional nature of New Zealand's eventual emissions reduction target is welcome. However, this means little in light of business having to deal with the immediate effects of an operational emissions trading scheme with looming economic impacts.

We are not asking the Government to renege on its commitment to address climate change – we think New Zealand needs to be a good international citizen and to protect its commercial interests. We also appreciate that New Zealand faces obligations under the Kyoto Protocol up to 2012. But the growing prospect of the global climate change process descending into a Doha Round-equivalent means that we can no longer simply assume that the current emissions trading scheme is the best long-term way forward.

We consider that a suite of options are available to Government to address this risk. Some of these are worthwhile regardless of one's view of the likelihood of a post-2012 global agreement, and could be achieved without legislative change while others require legislative amendments. These include:

1. provide maximum assistance to trade-exposed businesses through the use of Ministerial discretion under the Act and/or exemptions;

2. establish the equivalent of the Australian Climate Change Action Fund to provide assistance to those who do not otherwise qualify under the Act;

3. release terms of reference for the review before the end of this year and commence it at the start of 2011 to facilitate a more timely consideration of whether to continue the moderating features beyond 2012 expiry, to make the allocation methodology better suited New Zealand business conditions, or to readjust the phase out of assistance to match our trade competitors; and/or

4. suspend the introduction of the scheme pending action in Australia.

As time passes with no real evidence of international action to price carbon, it becomes harder and harder to justify the implementation of a trading scheme. Without international trading, even generous allocations are unlikely to be the best long-term policy response.

However, it is important to note that the shift to a lower carbon economy does not start and end with the emissions trading scheme. Other factors, such as rising world energy prices and changing consumer preferences are driving decarbonisation. Businesses are increasingly taking leadership in the delivery of low carbon goods and services to meet these changing conditions. Business looks to Government to work collaboratively to ensure that innovation and science is pointed at business, to encourage the commercialisation of new innovative goods and services, and to facilitate business capturing opportunities to sell their high-tech manufacturing goods and services offshore.

Getting the tactical response to changing international conditions right is critical to how business responds and the long-term durability of policy settings. In a world where governments are increasingly unlikely to come together to agree on global emission reduction limits, our members need to be sure that policy settings remain ‘fit-for-purpose’.

We ask that the issues raised in this letter be considered by the Government and look forward to working co-operatively through them with you.

Yours sincerely

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