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19 July 2018

Our Climate Your Say: Consultation on the Zero Carbon Bill
The Ministry for the Environment

Submitted by email to ZCB.Submissions@mfe.govt.nz

PEPANZ Submission: *Our Climate Your Say: Consultation on the Zero Carbon Bill*

Introduction

This document constitutes the Petroleum Exploration and Production Association of New Zealand's (PEPANZ) submission in respect of the Ministry for the Environment's *Climate Your Say: Consultation on the Zero Carbon Bill* (referred to hereafter as "the Consultation Document"), for which submissions close on 19 July 2018.

PEPANZ represents private sector companies holding petroleum exploration and mining permits, service companies and individuals working in the industry.

Executive summary

- We support the comprehensive public policy process being used to develop the Zero Carbon legislation.
- Risks of carbon leakage, whereby firms relocate to countries with less restrictive emission policies, should be front-of-mind when developing domestic emissions policies.
- Economic cost and the competitiveness of firms should be critical considerations, especially given the trade-exposed nature of the New Zealand economy.
- The Government should set a goal to reach net zero emissions in the second half of the century[1], and request the Climate Change Commission to advise on the specific target for the Government to set later.
- Setting the specific target should follow careful consideration of the costs and benefits, and should account for global actions.
- New Zealand should pursue emission reductions and maintain international credibility, but policy-compelled reductions should fundamentally only be required in a manner that is comparable with actions of New Zealand's trade competitors.
- We consider that although a Climate Change Commission could be beneficial, a clear problem definition with the status quo institutional arrangements has not been adequately presented.

[1] Noting that the Paris Agreement specifies this should happen in the second half of the century, not in 2050 per se.

- The Climate Change Commission should have the advisory and monitoring functions as proposed. We consider it is appropriate that the democratically accountable political executive has ultimate responsibility for decisions.
- The Climate Change Commission should advise on the specific emissions target for the Government to set later.
- Access to legitimate international units should be enabled, given the fundamental value of the Emissions Trading Scheme, compared to a simple carbon tax, is that it enables international trading to achieve emission reductions at the lowest marginal cost
- Provision should be made for revising targets and emission budgets because the future is uncertain, and many contingencies exist (e.g. technological, scientific, social and economic developments). Put simply, to preclude revisions would presume too much about the future.
- We support the criteria proposed for consideration by the Climate Change Commission, but submit that it should also consider 1) the emissions policies and action of New Zealand's trade competitors, 2) risks of carbon leakage, and 3) realism about technological innovations.
- The essential skills and expertise on the Climate Change Commission should include 'understanding of business competitiveness'.
- The relationships between relevant agencies (e.g. MfE, local government, and the proposed Climate Change Commission) should be carefully considered to avoid duplication and to ensure roles and responsibilities are clear and meaningful.

Part 1 – Overarching comments

We support the process for establishing the Zero Carbon legislation

We support stable and predictable policy settings, as these are particularly important for the petroleum sector with its long lead times and significant capital and operating costs, especially in frontier basins with uncertain geological prospectivity such as New Zealand.

We must note that arbitrary and unilateral decisions, such as the Government's announcement of 12 April 2018 to cease issuing offshore petroleum exploration permits, are extremely damaging to investor confidence throughout the economy. To see the Zero Carbon legislation being developed through an open and consultative policy process is positive and welcomed by our sector.

Carbon leakage is of key relevance to the petroleum sector

The competitiveness of New Zealand firms and corresponding risks of carbon leakage should be foremost in mind when developing climate policy. The petroleum sector is a global and trade-exposed industry, which means cost imposts on goods which are either exported or face import substitutes cannot be simply passed on to consumers. This is especially relevant to exported oil and natural gas (natural gas is exported from New Zealand after conversion to methanol).

We supported the Productivity Commission when it said in its Issues Paper of August 2017 (page 85):

> "A controversial effect of emissions pricing is raising the costs of domestic firms exposed to international competition from firms in other countries that face either a zero or lower price on their emissions. Possible negative impacts are:
>
> - domestic firms may not be able to compete or even be forced to close;
> - over time, production may re-locate and grow in countries without emissions prices; and
> - global emissions may stay the same or even increase if production in other countries is more emissions-intensive than the lost New Zealand production. Further, such production shifts could be hard to reverse even after emissions price parity is reached in the other countries."

New Zealand petroleum production is susceptible to carbon leakage to jurisdictions that lack comprehensive emission taxes or trading schemes. Carbon leakage may shift production to nations with poorer standards, or that involve more emissions when produced and refined. For example, New Zealand oil is less emissions-intensive than Venezuelan bitumen oil, Canadian tar sands, or heavy crudes from Saudi Arabia.

High level comment on the Consultation Document and a net-zero target

The framing of the Consultation Document seems to presume that a Climate Change Commission is both necessary and the most appropriate institution to oversee climate policy. Although we are confident that a Climate Change Commission could be beneficial, as a matter of sound policy we would expect to see a problem definition and intervention logic to justify the presumption in favour of a new entity.

Overall we are comfortable with the proposed *framework* (in terms of the mechanistic details), and are broadly supportive of achieving net-zero emissions as required by the Paris Agreement. However, we consider setting the 2050 emissions target should follow careful consideration of the costs and benefits. Net-benefits of certain courses of action should not be simply assumed, and nor should hope that any necessary technological developments will arise.

Based on the analysis in the Consultation Document, the economic challenges of a net-zero 2050 target are indeed significant, and it is highly uncertain whether these downsides would achieve the stated goal. As stated on page 25 of the Consultation Document, these challenges mean we could face:

1. *"slower rates of economic growth as a result of higher emissions prices and other transition policies*
2. *competitiveness issues in trade-exposed emissions-intensive industries*
3. *decline in output and jobs for higher emissions sectors*
4. *slower rates of growth in household incomes."*

These are clearly major downsides to the proposed target, and that these are downsides is an inescapable conclusion. Indeed, economic commentator Michael Reddell stated: "I have never before heard of a government consulting on a proposal to cut the size of the (per capita) economy by anything from 10 to 22 per cent."[2]

Given those express downsides, we find the language about "upgrading" New Zealand's economy through decarbonising to be unusual, as the so-called "upgrades" actually materially weaken the economy in every scenario.

Turning to the upsides, we are told we could see:

1. *"higher rates of innovation in sectors exposed to a higher emissions price, leading to an up-lift in productivity*
2. *new business opportunities in lower emissions sectors*
3. *less time wasted in traffic congestion and improved health from switches to public and active transport*
4. *health benefits from warmer and drier homes*
5. *if the rest of the world acts as well, reduced impact on our economy from climate change efforts."*

The first and second points are likely true, and while they can be counted as opportunities, they do not fully offset the downsides. This point is demonstrated by the fact that each pathway to net-zero 2050 shows materially lower GDP compared to the counterfactual. That is to say, while new economic activity may arise and policy-driven innovation may occur, this only partially offsets the negative economic effects of a net-zero 2050 target.

The third and fourth points are spinoff benefits, and while not to be discounted, these are not the aim of the emissions targets. Certainly, those outcomes could be achieved through other interventions without the major downsides associated with the emission targets in the Consultation Document.

The fifth and final point is critical, because with New Zealand contributing 0.17% of global emissions[3], we cannot influence global outcomes. As the consultation document states, reducing climate change requires "the rest of the world to act", and at this stage we cannot be sure of genuine and comprehensive global action. In the event of inadequate global action, if New Zealand's goal is too ambitious or if we act too early, the ultimate outcome is to materially weaken the economy for very little global benefit, and to also enter *path dependency* and accordingly forego options which have value.

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[2] *The government consults on slashing productivity growth.* Available at: https://croakingcassandra.com/2018/06/08/the-government-consults-on-slashing-productivity-growth/

[3] *New Zealand's Greenhouse Gas Inventory 1990–2015*, page 5. Available at: http://www.mfe.govt.nz/sites/default/files/media/Climate%20Change/final_corrected_Greenhouse%20Snapshot%202017_Sept%202017.pdf

For this reason, although we should certainly pursue emission reductions and maintain international credibility, policy-compelled reductions should fundamentally only be required in a manner that is comparable with actions of New Zealand's trade competitors. In setting emission targets and policies (including free allocation of units to emissions-intensive, trade-exposed sectors), it is critical to consider the revealed (rather than simply stated) preferences and actions of trade competitors. This is necessary to ensure the ongoing competitiveness of domestic firms.

Part 2 - Responses to questions in the Consultation Document

In this section we provide answers to the specific questions outlined in the Consultation Document.

Question 1. What process should the Government use to set a new emissions reduction target in legislation?

We consider that the Government should set a goal to reach net zero emissions in the second half of the century[4], and request the Climate Change Commission to advise on the specific target for the Government to set later.

Question 2. If the Government sets a 2050 target now, which is the best target for New Zealand?

We do not express a view, as we consider the Climate Change Commission should advise on the specific target as per our response to Question 1.

Question 3. How should New Zealand meet its targets?

In addition to domestic emissions reductions (including from new forest planting), we support using international carbon units to help meet New Zealand emission targets (as did the Productivity Commission in its Draft Finding F4.6). The fundamental value of the Emissions Trading Scheme, compared to a simple carbon tax, is that it enables international trading to achieve emission reductions at the lowest marginal cost. To realise that goal, it is essential that international units can be used.

Noting that international carbon markets have not emerged, we support using bilateral or multilateral arrangements between agreeable states. On this theme, we support the Productivity Commission when it says in its Draft Report on the Low Emissions Economy:

> "The other approach of the Paris Agreement for internationally transferred mitigation outcomes is a government-to-government "cooperative" approach that lets countries coordinate trading among themselves, provided they follow accounting principles approved by the UNFCCC. An example of this approach is a voluntary and cooperative "climate team model" being explored between the governments of New Zealand and Columbia. New Zealand would "invest in" emission reductions in Columbia that are over and above Colombia's NDC. The payments would flow in direct proportion to verified reductions within an agreed price range and maximum budget. (p97)

Question 4. Should the Zero Carbon Bill allow the 2050 target to be revised if circumstances change?

Provision should be made for revising the target, because the future is uncertain, and many contingencies exist (e.g. technological, scientific, social and economic developments). Put simply, to preclude revisions would presume too much about the future.

Question 6. Should the Government be able to alter the last emissions budget (ie, furthest into the future)?

We consider that the Government should be able to amend the furthest emissions budget. Such a provision provides a new, democratically-elected Government with the ability to have influence over climate policies and the economic course to meet targets.

Relevant factors that could warrant budget revisions could include major scientific developments, or seriously undesirable economic consequence, natural disasters or conflict. We are conscious that it would be difficult to prescribe criteria, so suggest a simple provision along the lines of "in exceptional circumstances" and to require the Government to explain why it considers circumstances to be exceptional in the event of exercising the right.

[4] Noting that the Paris Agreement specifies this should happen in the second half of the century, not in 2050 per se.

Question 7. Should the Government have the ability to review and adjust the second emissions budget within a specific range under exceptional circumstances?

We support the Government having the ability to adjust the second emissions budget, for the reasons outlined in our response to Question 6.

Question 8. Do you agree with the considerations we propose that the Government and the Climate Change Commission take into account when advising on and setting budgets?

We support the criteria outlined on page 44, which would require the Climate Change Commission and Government to consider:

- "scientific knowledge about climate change
- technology relevant to climate change
- economic circumstances and, in particular, the likely impact of the decision on the economy and the competitiveness of particular sectors of the economy
- fiscal circumstances and, in particular, the likely impact of the decision on taxation, public spending and public borrowing
- social circumstances and, in particular, the likely impact of the decision on fuel poverty
- energy policy and, in particular, the likely impact of the decision on energy supplies and the carbon and energy intensity of the economy."

It is crucial for the Commission and Government to consider economic implications, costs, and impacts on the competitiveness of firms, so we strongly support these as criteria. We submit that several other factors or variations should also be considered for inclusion:

- <u>The emissions policies and action of New Zealand's trade competitors,</u> to ensure that domestic firms remain competitive. Relevant to this is the statement in the Consultation Document (p19), that "Moving too early could affect the competitiveness of our trade-exposed businesses. This risks relocation of production to countries with less stringent climate policies".
- <u>Carbon leakage</u>, and a focus on policies that will result in reductions in *global* emissions, not just domestic emissions. The framework should provide for new upstream and industrial developments in New Zealand, even those that increase domestic emissions, where this is globally rational from an economic and climate change perspective.
- In relation to <u>technology relevant to climate change</u>, the Commission and Government should be practical and realistic about what technologies are available and economically and technically feasible at scale. We should only set goals that we know can realistically be achieved and should not rely on mere hope that the right technologies and innovations will come along. To rely on hope compromises the credibility of the goal itself, and means that the negative economic effects will be harsh as sectors have to step up efforts more than was originally imagined to be required.
- Although not perhaps necessary as an explicit criterion, the Commission and Government should also act in manner that is mindful of New Zealand's minor contribution to emissions and the country's consequent inability to influence climate. We note the Consultation Document's own statement (p25) that "if the rest of the world acts as well, ["we could see"] reduced impact on our economy from climate change efforts". So in the absence of meaningful global action, our actions serve to, in aggregate, weaken the New Zealand economy.

We do not support the consideration on p45 of the Consultation Document to include "global and local leadership". This is because such a criterion is very difficult to quantify, and because 'leadership' itself does not actually reduce emissions.

Question 9. Should the Zero Carbon Bill require Governments to set out plans within a certain timeframe to achieve the emissions budgets?

Yes, providing these plans are informed by sound criteria and consultation, and that they have flexibility to be amended.

Question 10. What are the most important issues for the Government to consider in setting plans to meet budgets? For example, who do we need to work with, what else needs to be considered?

Please see our response to Question 8 above.

We consider the value of future options should be factored into decisions, i.e. before regulatory decisions that preclude a pathway are made (e.g. such as the decision of 12 April 2018 to cease issuing offshore petroleum exploration permits).

Relying on pricing mechanisms under the ETS requires less central planning, so reduces the regime's susceptibility to rent-seeking and special interest lobbying and the hidden wealth transfers that would arise from inefficient bans and subsidies.

To ensure access to the best available information, we submit that the Commission and Government should consult publicly on the development of budgets.

Question 11. The Government has proposed that the Climate Change Commission advises on and monitors New Zealand's progress towards its goals. Do you agree with these functions?

We support the Commission having advisory and monitoring functions as proposed. We consider it is appropriate that the democratically accountable political executive has ultimate responsibility for decisions. This is due the normative nature of the decisions (i.e. relating to 'what ought to be') which could have deep and wide impacts across the entire economy and society. Giving the Commission an advisory-only function also increases the likelihood of the Commission successfully enduring changes of government in the future.

Question 12. What role do you think the Climate Change Commission should have in relation to the New Zealand Emissions Trading Scheme (NZ ETS)?

We do not express a view on this question, but suggest careful consideration of the intended relationship between 1) the Ministry for the Environment and Environmental Protection Authority as current policy makers and administrators and 2) the proposed Climate Change Commission.

Because the Consultation Document has not presented a problem definition associated with MfE advising on and the EPA administering the ETS, it is unclear why it is simply presumed that the Commission will *either* advise on the ETS or have decision rights on the ETS.

Question 13. The Government has proposed that Climate Change Commissioners need to have a range of essential and desirable expertise. Do you agree with the proposed expertise?

We support the list of expertise proposed, but consider that understanding of business competitiveness could be elevated from 'desirable' to 'essential'. This is because as a small, trading nation the competitiveness of firms is crucial for our economic and social well-being.

Question 14. Do you think the Zero Carbon Bill should cover adapting to climate change?

We do not express a view on this question, but suggest careful consideration of the intended relationship between agencies (including MfE and local government and the Climate Commission if it is given a role in adaptation) in terms of adaptation policy. The is important because currently the Resource Management Act is administered by MfE and given effect to by local government and is the "key piece of legislation for adapting to climate change and associated natural hazards."[5]

DOC is also relevant given its role in administering the New Zealand Coastal Policy Statement, which " includes specific policies for the management of coastal hazards and requires consideration of the effects of climate change."[6]

Question 15. The Government has proposed a number of new functions to help us adapt to climate change. Do you agree with the proposed functions?

In relation to these two questions, the role and responsibilities of current agencies should be considered and assessed as to whether there is a problem with the status quo. Any decisions on new functions should be guided by that assessment.

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[5] http://www.mfe.govt.nz/climate-change/what-government-doing/adapting-climate-change/adaptation-and-central-government

[6] iBid

Question 16. Should we explore setting up a targeted adaptation reporting power that could see some organisations share information on their exposure to climate change risks?

In relation to these two questions, the role and responsibilities of current agencies should be considered and assessed as to whether there is a problem with the status quo. Any decisions on new functions should be guided by that assessment.