

This article was first published in the *Otago Daily Times* on 24 April 2009

### **Breathing Space Available on Climate Change Policy**

Several recent developments are altering the context in which climate change policy is being framed.

The Ministry for the Environment reported this month that New Zealand is likely to be in surplus with respect to its Kyoto obligations in the period to 2012, rather than in deficit.

This undermines the argument that if industry doesn't reduce carbon emissions, "the taxpayer will have to pick up the tab".

Moreover, the argument was always shaky: it is far from clear that a Kyoto liability will ever be called up, or that countries in surplus will receive cheques from the rest of the world.

The new calculation gives New Zealand some breathing space, and ironically the current economic recession is constraining the growth in emissions more than feasible climate change policies would have done.

The recession is likely to remain the dominant issue for international policymakers this year. Governments will almost certainly not take costly action until economies recover.

As a result, there may be few concrete post-2012 commitments at the UN conference in Copenhagen this December.

Obama administration officials are reported as saying they "need time to gauge the American public's appetite for an ambitious carbon reduction scheme before leading any international effort."

China and India, which are rapidly becoming the world's largest emitters, are unlikely to agree to credible binding commitments.

As an Indian official recently put it, "It is morally wrong for us to agree to reduce when 40 percent of Indians do not have access to electricity."

Across the Tasman, the Rudd government is encountering difficulties with its climate change legislation in the Australian senate. It plans to delay final decisions until after Copenhagen.

It makes sense for New Zealand to work to a similar timetable, particularly given the agreement between the two governments to coordinate policies.

Just as developing countries are not expected to do as much as developed countries to curb emissions, New Zealand's actions should be less ambitious than Australia's because it is a wealthier country.

None of this argues against exploring the best policy options for reducing emissions. However, there is no point in New Zealand taking additional action in advance of major emitters.

There are signs that the government and the select committee reviewing the emissions trading legislation are now proceeding in a more careful and measured way.

Two economic consultancy organisations, Infometrics and the New Zealand Institute of Economic Research, have been commissioned to examine the economic costs of various policy scenarios.

This work should be a helpful input for the select committee, whose terms of reference require "a high quality, quantified, regulatory impact analysis to be produced to identify the net benefits or cost to New Zealand of any policy action, including international relations and commercial benefits and costs."

On the cost side, the most important scenario that needs to be analysed is one based on a rate of economic growth that is consistent with the government's aim of catching up with Australian income levels by 2025. No work appears to have yet been done to quantify benefits.

When a full regulatory impact analysis is available, interested parties will have the opportunity to appear before the select committee to comment on it.

Another part of this analysis must look at the relative merits of a carbon tax and an emissions trading (cap-and-trade) scheme (as well as less ambitious approaches such as an energy tax).

Much economic opinion prefers a carbon tax. A 2007 US Congressional Budget Office assessment came down in favour of a tax, saying: “Although both types of incentive-based approaches are significantly more efficient than command-and-control policies, studies typically find that ... a well-designed and appropriately set tax would yield higher net benefits”.

One reason is the greater certainty about the price effect of a carbon tax relative to the likely price volatility of an ETS. Such certainty is a major advantage for firms and households, and for the political sustainability of any policy.

There is time to carefully evaluate all approaches – climate change is a multi-decade issue.

Some environmentalists have claimed that it is inconsistent for business organisations to show interest in a carbon tax when many of them opposed the previous government’s carbon tax proposal.

Such claims are baseless: earlier opposition was directed at *any* additional action ahead of Australia and the United States, not at particular mechanisms.

It is, in fact, the Green Party and environmental groups which earlier favoured a carbon tax that are being inconsistent in favouring an ETS today.

The lesson of past abortive efforts to implement climate change measures is that New Zealand needs quality decisions, not rushed ones.

The new calculations on New Zealand’s liability, the international recession and the likely caution by other governments allow time to reach sustainable decisions that truly reflect the public’s balancing of benefits and costs.

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