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Saving the Planet Must Not Cost the Earth

Shortly a select committee of parliament will begin hearings on the bill to implement an emissions trading scheme (ETS).

This is the centrepiece of the government's contribution to international action to respond to global warming.

Most political parties appear supportive of the case for New Zealand to take further action, as do most business organisations. But large questions remain about the design and implementation of New Zealand's response.

In the hearings there may not be a lot of debate about the science of global warming, although many uncertainties remain. In the broader international context, the non-adherence to Kyoto commitments of the United States, China and India is a major obstacle to coherent action. It is not at all clear what will follow the Kyoto Protocol after 2012.

Most of the deliberations on the bill, however, will be around economic and political issues.

The key economic issue is what sacrifices in living standards New Zealanders should be asked to make in return for the benefits of contributing to international action.

The benefits are only environmental to a miniscule extent (since New Zealand barely makes a difference to global emissions, and may be a beneficiary of modest warming).

Rather, they mainly take the form of protecting our commercial interests and our international relations.

Unfortunately, the government has made no serious effort to assess the size of these benefits or the costs of policy action. Should New Zealanders

be asked to face economic costs of, say, \$50 million, \$500 million or \$5 billion a year in return for possible benefits? How much is too much?

At a time when many households are struggling with rises in electricity, petrol and other prices, the voting public needs to know the cost-benefit trade-off. Unless voters buy into it, initiatives may be politically unsustainable, as earlier experience with the proposed methane levy and carbon tax demonstrated.

Many issues will be raised with the select committee.

One is whether a modest carbon tax would be superior to an ETS, at least initially. Such a tax, which would allow other taxes to be reduced, is favoured by most leading economists, largely on the grounds that it provides greater certainty for business decisions, is transparent, and less open to abuse.

If an ETS is adopted, most business organisations believe there needs to be a ceiling on the price of carbon units that businesses will face.

A large issue is the position of so-called 'competitiveness-at-risk' industries such as steel, cement, aluminium, wood processing, and much of agriculture. Particularly given the uncertainties about post-2012 arrangements, it makes no economic or environmental sense for these industries to contract or be stunted in their growth if the consequence is a shift in production to less efficient and higher emitting industries abroad.

The government's plans to shelter such industries only for a transitional period could put jobs and investment seriously at risk.

An issue which seems to have received almost no attention is the institutional arrangements for running an ETS. An ETS is like a tax, and we have strict institutional arrangements, such as an independent tax commissioner and appeals to courts, to prevent political interference in tax administration.

In Australia, careful thought is being given to institutional arrangements. A recent official report emphasises that "Sound governance arrangements

are necessary to issue permits and to ensure that permits are acquitted in line with emissions. In Australia, there is a place for an independent institution playing a central role in administration of the ETS, within policy parameters established by legislation. In this report we refer to such an institution as the Independent Carbon Bank.”

In the bill, the administrative role is left to ministerial discretion, which poses risks of favouritism at best and corruption at worst.

Another major issue is that the government has added to the ETS a proposed moratorium on thermal electricity generation. It is illogical to combine a market-oriented measure (a tax/subsidy scheme or an ETS) with a draconian regulatory measure. This is a recipe for economic distortions and a disincentive to gas exploration and to improving security of electricity supply.

Beyond all this are questions about the scope and ambitions of the government’s proposals. It makes no sense for New Zealand to get ahead of other countries, and there are strong arguments for some level of alignment with Australia’s plans. These will not be clear until later this year.

The possible consequences of badly designed arrangements cannot be over-emphasised. Rapid moves towards the government’s goals of carbon neutrality are simply inconsistent with robust growth in the economy and household incomes.

Currently the government’s plans look like a case of more haste, less speed. Far more in-depth analysis and careful preparation is apparent in the process being followed in Australia. Embarking on a course that turns out to be politically unsustainable serves neither business nor environmental interests well.

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