

## No U-Turn on Carbon Tax

The Business Roundtable has welcomed National Party leader John Key's indication that the new government will be willing to consider the merits of a carbon tax vis-à-vis an emissions trading scheme (ETS) as a response to climate change.

Executive director Roger Kerr said that its belief that a carbon tax might be superior to an ETS was not a reversal of its earlier views.

"We opposed the previous government's carbon tax proposal not because we thought an ETS was better. We opposed it, first, because there was no rigorous analysis to indicate that taking any additional action was in New Zealand's interest at that time, and, secondly, because we did not support the government's 'lead the world' approach of taking action ahead of major trading partners such as the United States and Australia.

"Australia has now ratified the Kyoto Protocol and the new US administration may have a different approach to the issue. So in our submission on the emissions trading bill last year (see attached extract) we indicated a preference for a carbon tax, coupled with a subsidy for forestry sinks, if New Zealand were to take additional action."

Mr Kerr said that this position was based on the overwhelming weight of opinion among eminent economists that a tax/subsidy regime is superior to an ETS, for the reasons set out in the Business Roundtable's submission.

"In addition, there is political advantage in beginning with a low tax (we suggested in the \$5-10 per tonne of CO<sub>2</sub> range) in that firms and households would have greater certainty about the impact and might therefore be more willing to support what has to be a stable, long-term policy."

Mr Kerr said that some business sector players were approaching the issue from the viewpoint of their interests in benefiting from trading in carbon rather than the national interest.

"Moreover, forestry interests would not be disadvantaged with a tax/subsidy regime instead of an ETS because they would receive a subsidy for carbon sinks associated with tree planting."

Mr Kerr said that the Australian Productivity Commission had recommended that Australia begin with a modest carbon tax and transition to an ETS if a deep, liquid international trading market developed (which is not in prospect at present).

"We think the select committee that will review the ETS legislation should seriously consider a similar approach, provided it is presented with sound analysis from government officials that taking additional action is in New Zealand's interests", Mr Kerr concluded.

19 November 2008

For more information contact:  
Roger Kerr  
Executive Director  
Ph: +64 4 499 0790  
Email: rkerr@nzbr.org.nz

[www.nzbr.org.nz](http://www.nzbr.org.nz)

**Extract from New Zealand Business Submission on the Climate  
Change Emissions trading and Renewable Preference) Bill  
February 2008**

“At a high level, an emissions tax (coupled with a subsidy for carbon sinks) and an emissions trading scheme are similar. Both have the desirable property (compared with regulations) of being price-based, thus allowing participants in markets to determine least-cost ways of reducing emissions. A tax/subsidy scheme establishes a price and allows markets to determine the quantity of emissions. An ETS sets permitted levels of emissions and allows trading in markets to determine carbon prices.

The Bill favours an ETS over a carbon tax on the grounds that it is in line with the quantitative framework established by the Kyoto Protocol and would provide more fiscal certainty for the government. However, the last point is not a national interest justification since what is good for the public accounts is not necessarily good for New Zealanders. Further, as the proposed ETS shifts an increasing proportion of the burden of the Kyoto liability onto the private sector after 2013, the fiscal cost will fall, and could become a large surplus.

We have extensively researched the academic literature and found that the overwhelming majority of eminent economists who have studied this issue favour a tax/subsidy scheme over trading. Their reasoning is typically as follows:

- A tax provides much greater certainty for business and investment decisions. With an ETS, prices may be extremely volatile, as EU experience has shown. The economic costs of volatility may be very high.
- If a tax/subsidy scheme does not generate an emission reduction path that is consistent with international targets, it can be adjusted from time to time, like other taxes. Because global warming is a very long-term issue, any deviations from desired quantity targets can be corrected if warranted. Such periodic adjustments (say every 5 or 10 years) would not reintroduce significant uncertainty. In any case there is uncertainty about the optimal number of permits to issue – making this a learn-as-you-go exercise also.
- A tax/subsidy scheme is a transparent instrument which is subject to parliamentary oversight and facilitates clear accountability to voters. An ETS is not transparent, which is no doubt why it is attractive to politicians in some other countries (although a number have imposed carbon taxes instead of or as well as an ETS).
- An ETS is much more open to political favouritism and abuse than a tax/subsidy regime. This has been clearly demonstrated by EU experience. The Bill provides for a great deal of ministerial and bureaucratic discretion which could well lead to inefficient, unfair and, at worst, corrupt outcomes.
- A carbon tax would raise revenue for the government which could be applied to reducing other distortionary taxes, in particular income tax. This was the recommendation of the 2001 (McLeod) Tax Review which favoured a tax rather than a trading approach.

- A tax/subsidy regime is likely to be simpler and less costly to administer and comply with.

At no stage did the Business Roundtable oppose a carbon tax proposal – our earlier concern was (and remains) that any intervention should be rigorously justified. We see a tax/subsidy regime as a better initial option for New Zealand, until such time as it is clear that a viable international market for trading has developed. That was also the view of the Productivity Commission of Australia in a 2007 report.

We consider that an initial tax should be set at a low level. This is in line with earlier government thinking which recognised the limited opportunities for emission reductions in the short to medium term. We suggest that an initial tax should not exceed the \$5-10 per tonne of CO<sub>2</sub>e range. This would already be a significant burden for some emitters. For New Zealand Steel, for example, which emits around 2 million tonnes of CO<sub>2</sub> annually, a tax of \$10/MT would represent a cost of \$20 million. This would be a severe hit to its profitability and put jobs at risk.”