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Morgan Foundation Submission to Emissions Trading Scheme Review

Thank you for the opportunity to make a submission.

Unfortunately this submission is not as illuminating as we would like it to be as there are glaring gaps in the evidence base, particularly on the costs of the various options to transition to a low carbon economy.

In our view those evidence gaps need to be plugged, then a proper, informed consultation can take place about the pace of change.

A credibility problem

The Emissions Trading Scheme faces a credibility problem. It has been perverted by unlimited access to cheap, dodgy credits from the Ukraine and Russia.

This scam has had far reaching effects - $200m ended up in the pockets of foreign fraudsters, polluters profited, forests were felled and our emissions rose. Ultimately, we have made our own job of reducing emissions harder in the long term.

The Emissions Trading Scheme is supposed to be our main tool to reduce emissions, but the Ministry's own evaluation says the scheme has been a complete flop. All it has delivered so far is a plentiful supply of cheap, dodgy carbon credits that we are using to claim we are meeting our international commitments.

This credibility problem cannot be overcome simply by returning carbon prices to $15 per tonne. Foresters are once bitten twice shy, and they face far greater issues in reforestation than the price of carbon. Furthermore, we need policy that will be effective at reducing gross emissions, not just getting trees planted. It will take bold action to restore the credibility of the Emissions Trading Scheme, and indeed the Government's climate policy generally. Our key recommendations are:

1. Dump the Junk - cancel an equivalent amount of units to the junk Emission Reduction Units handed over (97m). At the very least the projected surplus as at 2020 should be cancelled.
2. Limit future trade in international credits
3. Develop a plan to wean us off fossil fuels
4. Phase out free allocation
5. Conduct a review of land use and environmental effects
6. Set up an independent committee to oversee the plan

7. Explore other tools than the Emissions Trading Scheme
8. Start assessing the fiscal and economic risks now

1. Dump the junk

We need to make good on past mistakes, and hand over real credits in lieu of the fraudulent ones. Otherwise we risk becoming 'those guys' that cheated – we can't let that happen to New Zealand's clean, green, corruption-free international reputation.

In handing over the fraudulent credits to the United Nations last year in part payment of our undertaking to meet the 2008-12 target, we kept hold of 'good quality' credits to see us through to 2020 and beyond. On current projections we will have a surplus of 94 million credits in 2020. We should immediately cancel another 97m credits, or at the very least undertake to cancel any remaining surplus in 2020. Otherwise the proceeds of crime will still be being used as we move on to the 2030 target.

2. Limit future trade in international credits

The Government claims that we still need international trade in credits to meet our 2030 target. We question this - what would it cost to meet our 2030 target without trade? The work needs to be done on this point to inform a proper consultation.

In the meantime, our credibility is in tatters when it comes to international trade in carbon credits. It would be astounding if any credible nation wanted to engage with us.

To restore our integrity we need to make sure any future trade in credits actually reduces emissions. This is only realistic if we work closely with a small group of countries (for example some of our Pacific Island neighbours), and we limit international trade to a certain percentage of emissions (ironically what the 'supplementarity principle' of Kyoto always stipulated).

That means we need a plan to reduce domestic emissions – in other words we need to start weaning ourselves off fossil fuels.

3. Develop a plan to wean us off fossil fuels

Currently our plan for reducing emissions is simply having a price on carbon through the Emissions Trading Scheme. Cap and trade schemes like the ETS are great in theory. However for the 'trade' bit to work there needs to be a 'cap' on emissions – hence the name. When there is no cap, the trade bit is pointless - we've seen that with the fraudulent credits where the price fell from over $20 to as low as 15c per tonne.

The consultation mentions the idea of 'auctioning' credits – without a mention of what the cap should be. To have a credible cap New Zealand needs to work out how much of our target we will meet domestically.

Any discussion on domestic reductions needs to be informed by the answers to this question – what is the least cost way to wean ourselves off fossil fuels over time? Sadly, we can't answer this or other basic questions, as shown by the Royal Society report released yesterday. Without that information the current consultation is a bit pointless.

Any such exercise needs to reframe the transition to a low carbon economy from one that is focused solely on costs. First it would help to acknowledge that there are benefits to the transition too – such as healthier citizens and cleaner rivers. We must accept that there will be some costs, the only question is when is the *least* cost time to make the change. Buying international credits will prove more costly in the long term, and it will eventually prove impossible. What the Paris Agreement makes clear is that the planet needs to wean itself off fossil fuels this century – so eventually we will have nobody to trade with.

We also need to move away from claiming this task is really hard. New Zealand's task is partly more difficult because of the size of our agriculture industry. However, the rising cost of change is chiefly due to past inaction - even excluding agriculture we have gone backwards in the past seven years. The longer we take to move to a low carbon economy the more expensive that transition will be.

4. Phase out free allocation

The Ministry for the Environment's own analysis suggests that agriculture plus existing handouts of free units to businesses will exceed our entire national emissions allowance by 2030. We have to challenge the assertion that environmental controls hurt export competitiveness. There is a need to phase out the protection of emissions-intensive industries under the ETS.

In our view, given the bank of units that was built up during the time of cheap ERUs, there should be a one year moratorium on free allocation to run down the bank and signal that free allocation is on the way out. We also support the Parliamentary Commissioner for the Environment's call for a schedule to be established for the phase out.

5. Conduct a review of land use and environmental effects

The exclusion of agriculture from the Emissions Trading Scheme means that those emissions are projected to continue to grow as a result of increasing production. This outcome seems bizarre in lieu of the increasing pressures not only to reduce emissions but also in biodiversity and water quality – the Government has committed that water quality will be maintained or improved.

The environmental impacts of land use need a thorough independent review so that the country can put in place integrated, simple incentives for appropriate land use in the appropriate area. The Kyoto accounting for methane is probably inappropriate, but for reasons of water quality and climate emissions there should be disincentives to increase stock numbers. Also, simply putting a price on carbon will not restore confidence to our forestry industry – we need a strategy.

6. Set up an independent committee to oversee the plan

Given the lack of credibility in our current approach to climate change, we should look at the UK's model for progress. Under the Climate Change Act the UK has an independent Committee that recommends emission reduction goals, pathways, policy tools and does the monitoring.

Please note that having an independent committee of experts is different to a collaborative process ala the Land and Water Forum. This group needs to be resourced to do independent expert research and analysis on the ideal pathway to a low carbon economy.

7. Explore other tools than the Emissions Trading Scheme

Finally, we can help rescue the Emissions Trading Scheme (ETS) by not expecting it to deliver everything. In the UK and Europe they have had more success reducing emissions using regulation and contracts (such as feed in tariffs) than through putting a price on carbon. We face similar issues here, as recent analysis suggests the ETS will not be enough to achieve the Government's target of 90% renewable electricity.

The Emissions Trading Scheme is a good idea in theory, but to achieve the impacts needed the price on carbon may have to be hundreds of dollars per tonne. Being a politically created scheme, it is unlikely politicians will ever let the price go that high. The temptation will always be to interfere and fiddle with the rules, as has happened for the past seven years.

Ultimately what businesses need in order to transition to a low carbon economy is certainty. Taxes and cap and trade schemes don't deliver that as they can be fiddled by politicians – other policies will be needed. Here's a few examples of ideas to investigate:

- A review of electricity pricing structures to ensure the best incentives are in place for renewable micro-generation (e.g. solar and community wind-farms) and consumers (e.g. how to reduce the peaks in electricity demands).
- New Zealand is one of the few developed countries without fuel efficiency standards for vehicles.
- Why do public transport passes attract fringe benefit tax but car parks don't?
- Why are local authorities obsessed with minimum parking requirements which encourage car dependence?
- Public sector fleets should be converted to hybrid and electric cars over time.

- Regulation and incentives to stop new coal boilers being built and shift to woodchip boilers instead.

8. Start assessing the fiscal and economic risks now

As the Parliamentary Commissioner for the Environment has pointed out, there are a number of fiscal and economic risks associated with climate change that are completely predictable. A certain amount of climate change is locked in over the next 30 years and we should begin planning for that now. The Treasury and Ministry for the Environment should begin planning now for the rise of these completely predictable fiscal and economic risks.