ACT New Zealand Party minority view

The Emissions Trading Scheme Review Committee was set up with terms of reference to examine 10 specific aspects of this policy issue and report to the House accordingly.

The essence of the matter is that New Zealanders are being asked to cut their incomes on the grounds that "science" has proven beyond reasonable doubt that future human-induced climate change is likely to be dangerous; that cutting greenhouse gas emissions is the best human response to this problem; and that an ETS is the most efficient way to reduce net emissions.

The UN IPCC asserts that the matter has been proven beyond reasonable doubt. But it is neither impartial nor authoritative. Its charter obliges it to focus on human actions as a source of climate change. The flaws arising from its lack of care and self-selecting and self-referential nature have been documented by many authors and to some degree by inquiries held by the House of Lords and the Wegman Committee report.

Its most strident conclusions and "calls to action" advocacy are the work of a relatively small number of the contributing scientists who do not speak for the scientific community as a whole. More than 30,000 scientists have signed the following petition:

> We urge the United States government to reject the global warming agreement that was written in Kyoto, Japan in December, 1997, and any other similar proposals. The proposed limits on greenhouse gases would harm the environment, hinder the advance of science and technology, and damage the health and welfare of mankind.
>
> There is no convincing scientific evidence that human release of carbon dioxide, methane, or other greenhouse gases is causing or will, in the foreseeable future, cause catastrophic heating of the Earth's atmosphere and disruption of the Earth's climate. Moreover, there is substantial scientific evidence that increases in atmospheric carbon dioxide produce many beneficial effects upon the natural plant and animal environments of the Earth.

As the IPCC reports freely acknowledge in places, there are major scientific uncertainties, for example those relating to clouds, convection, solar activity, aerosols and the chaotic nature of some climatic processes. The surface of the earth has warmed, off and on, since the 19th century—and indeed for millions of years—but daily headlines conveying evidence of warmth, floods or storms tell us nothing about whether humans are causing climate change. The surface cooled for a period in the middle of the 20th century and appears to have stopped warming during the last decade despite strong emissions growth during this period. There is no doubt from the historical record that natural variability causes major changes in the earth's climate, sometimes in a relatively short number of years. Human-induced emissions growth could increase the global average temperature, but not necessarily to a dangerous extent.

Scientists who are most closely associated with the IPCC's most confident assertions about attribution put heavy weight on simulations conducted by climate change models. However, models are inevitably simplifications of a more complex reality. They embody many parameters whose values are highly problematic, and cannot usefully model what is unknown. As long as CO_2 was rising along with global temperatures, it was easy for the

models to attribute the latter to the former. But the models did not anticipate the contrary movement in the last decade. The models need to be told what caused it; scientists can speculate about the cause, but proving it is commonly another matter.

Another difficulty is that the earth warmed by perhaps only 0.7 degrees Celsius during the last century while atmospheric greenhouse gas equivalents rose 41 percent from a pre-industrial level of 281 ppm to 396 ppm by 2007. Because the relationship between temperature and concentration is logarithmic, the increase from 281 to 396 ppm should theoretically produce 95 percent of the temperature effect of doubling from 281 to 562. It follows that if 0.7 degrees were 95 percent of the full effect, humans should not be worried. The IPCC argument to the contrary is that 0.7 degrees can be nowhere near the full effect of the estimated 41 percent rise in atmospheric greenhouse gas concentrations. Instead, it conjectures that a much larger full effect is being delayed because of the temporary absorption of heat by the oceans. In due course that heat will be released in some form. Since it is not easy to measure the overall thermal content of the oceans of the world or to understand convection effects, this conjecture continues to be disputed. Other measurement controversies include whether the ocean level is rising on average and, if so, whether this is due to greenhouse gas emissions.

Given these uncertainties and measurement controversies it is easy to see why so many scientists consider that there is no convincing evidence in support of the alarmist propositions that are being used to steamroll politicians into making rash promises on climate change that they cannot implement successfully.

For policy-makers the bottom line is that if the climate is being driven by large natural but ill-understood forces, global governmental action to reduce emissions growth might be neither necessary nor effective. This is why ACT and many others argue that the extent of governmental global action should be conditional on the strength of actual scientific observations (as distinct from modelled simulations) that human actions are causing observed climatic outcomes. Climate change models do not constitute observational evidence. Furthermore, as Bjorn Lomborg has pointed out, spending large amounts of money to bring about a minuscule reduction in temperatures is a poor use of resources from the perspective of both current and future generations.

Finally, even if it was considered desirable to respond to such evidence as there is—for example, by application of a precautionary principle, or to be seen to be "playing our part" internationally, or to avoid risks of formal or informal trade restrictions—it is unlikely that an ETS is the most efficient policy solution. A low-rate carbon tax and subsidy scheme is a more appropriate initial step, with any advance from there dependent on the advance of scientific knowledge and on a fully international effort to reduce emissions.

Responses to the terms of reference

The following sections deal with, in turn, the items of the terms of reference of the committee.

Views from trade and diplomatic experts on the international relations aspects

The case for New Zealanders to "do their bit" to save the planet is not in itself a case for Government action. New Zealanders can, and do, "do their bit" as they see fit to reduce

their energy consumption without any carbon tax and without any hectoring from Greenpeace and other alarmists.

New Zealanders do not have a large "carbon footprint" amongst the relatively wealthy countries for their own consumption of goods and services. It is the farm products that are exported for world consumption that lift the carbon emissions per capita attributed to New Zealanders. Shifting the production of those products to other countries might make New Zealand look better in some comparative tables, but it could increase rather than decrease global emissions.

Mitigation by New Zealanders, tax-induced or otherwise, can produce no discernible climatic benefits for anyone. New Zealand emissions are too small to make a difference. The committee was advised by officials that New Zealanders should have to pay a carbon tax or ETS equivalent anyway—for the same reason that taxpayers have to pay taxes even if their individual contributions are minuscule. However, taxpayers should be happy to vote to pay a minuscule amount in taxes as long as the benefit is commensurate. To ask New Zealanders to vote to pay higher energy prices for no climatic or other benefits would be like asking them to vote to be taxed for no compensating benefits. Regardless of the human-induced warming issue, New Zealanders will have to adapt to any future changes in the climate, just as they have to adapt in their markets.

Another argument is that it is in New Zealanders' interests to pay higher energy prices in order to reduce domestic emissions because this will alter the behaviour of other countries. One suggestion is that mitigative action by New Zealanders might induce the rest of the world to follow suit and alter the global climate for the better from the perspective of New Zealanders. But it is so implausible that New Zealand actions could have a material influence on mitigation by China, the United States and India that it is no wonder that no expert attempted to make this argument.

Another suggested benefit for New Zealanders from voting for higher energy prices is that their participation in such global action would avoid adverse international trade and diplomatic repercussions. New Zealanders have rejected this argument in the past in relation to the nuclear-free issue; it is conceivable that they might do so again.

Wealthier countries like Singapore and Hong Kong are promising far less action than New Zealand and no case was made to the select committee that they are suffering as a consequence. Much larger countries such as Canada, Australia, and the United States have at various times stood aside from the issue to a greater extent than New Zealand.

The committee considered advice on whether border taxes might be imposed on countries that were not seen to be pulling their weight on the global warming issue. We were advised that border taxes could breach WTO rules and would be very difficult to implement and of doubtful effectiveness. They observed that there was a "strong wish" by trade ministers at the Bali meeting to avoid talk of trade sanctions and focus instead on positive incentives.

Another point is that any feasible action by New Zealand (or any other country) is bound to be criticised by alarmists and self-interested parties for not going far enough. Protectionists will use the food miles argument to try to disadvantage exporting countries

regardless of what New Zealand does. The relevant question is whether taking more rather than less action would make a worthwhile difference in this respect. It is understood that Fonterra, for example, regards its own moves to provide labelling information on the carbon content of its products as more relevant to its customers than official New Zealand policies.

ACT concludes that the case that a carbon tax might help New Zealanders avoid material adverse international trade and diplomatic repercussions is not strong and needs to be quantified. New Zealanders might be prepared to pay something to see New Zealand "playing its part", but no case has been made to date that they would wish to pay anything like the substantial costs of a commitment to reduce emissions to 10 percent or more below 1990 levels by 2020.

Consider the prospects for an international agreement post-Kyoto and the form this agreement might take

The committee was advised not to expect a comprehensive international agreement to be reached in Copenhagen. There is a deep divide between Annex I countries and other countries and a considerable reluctance amongst the latter for binding commitments. The emissions trading framework, which is associated by some with the Kyoto Protocol, may not be perpetuated.

The lack of attention to scientific uncertainties might underlie the bald assertion that future climate change obligations will become "increasingly stringent" for countries. It is not clear whose view this represents, but it could reflect an inability to assess the scientific uncertainties independently of the IPCC's bias. The fact of the matter is that it is not known whether new information will strengthen or weaken the alarmists' case for "urgent, decisive" action.

ACT's conclusion is that agreement by China, the United States, and India to binding commitments of a stringent nature is unlikely in the immediate future. We agree that New Zealand should be seen to be willing to play a part in any fully international effort to reduce global emissions. Thus the conditionality attached to the Government's targets for 2020 is sensible and prudent.

Require a high-quality quantified regulatory impact analysis to be produced to identify the net benefits or costs to New Zealand of any policy action

No such report was presented to the select committee. Since no analysis means no sound basis for taking policy decisions has been established, this omission fundamentally undermined what the select committee could hope to achieve in reporting back to the House of Representatives.

The NZIER and Infometrics modelling work assisted the committee in assessing some aspects of the costs of an ETS or a carbon tax. That work did not purport to be a regulatory impact analysis and it was not one, as officials have confirmed.

A regulatory analysis needs to evaluate likely benefits in relation to likely costs. The models used by the NZIER and Infometrics are not capable of estimating the likely benefits for New Zealanders from avoided adverse international diplomatic and trade repercussions from not participating in global action. As a result, the NZIER and Infometrics modelling work did not establish (and was not intended to establish) whether

it was plausible that New Zealanders would derive positive net benefits from a carbon tax or an ETS.

A regulatory analysis also needs to identify alternative courses of action and identify the option that maximises net benefits. Alternative courses of action include the choice between a carbon tax, an ETS with an uncapped price, an ETS with a capped price, and regulatory measures. The models could not easily distinguish between a carbon tax and an ETS and so were not very helpful in this respect. (They modelled an ETS as if it were a carbon tax.) Another option, suggested by Australian economist,, Geoff Carmody, is a tax on domestic consumption of carbon rather than on domestic production of carbon. (The effect would be to exclude much of agriculture.) The models could throw some useful light, however, on the costs of any obligation to purchase units overseas and on options for using the revenue from a carbon tax.

As New Zealand has found with the previous Government's ill-justified Kyoto obligations, a binding commitment to cover shortfalls by purchasing emissions units overseas has the potential to be very costly. Problems of "hot air", fraud, misrepresentation and unacceptable enrichment are likely. New Zealanders who wish to transfer money overseas for worthy causes already do so, and our official overseas aid programme supplements this activity. No case was made to the select committee that purchasing emissions units overseas would make a better contribution to global welfare than the use of those funds in better-targeted ways. If the purpose of spending that money is to appease international opinion in relation to climate change then consideration needs to be given to the optimal way of appeasing that opinion. If the purpose is to raise global welfare then it seems unlikely that purchasing "hot air" units is optimal. Moreover, by reducing national income, a carbon tax makes overseas aid less affordable.

We were advised that non-Annex I countries wealthier than New Zealand are amongst those thinking of taking domestic action to reduce emissions that falls short of making "firm future commitments".

ACT suspects that the reason why no regulatory impact analysis has been produced that credibly establishes a positive net benefit for New Zealand from mitigative actions is that none can be produced. However, the hypothesis should be tested by the Government undertaking one, as the Cabinet Manual requires.

Identify the central/benchmark projections that are being used as the motivation for any climate change policies and consider the associated uncertainties and risks

The majority report usefully summarises the central scenario projections, but it does not comment on their relative reliability or their absolute reliability for policy purposes. ACT has no confidence in the ability of scientists, or IPCC bureaucrats, to predict future changes in energy-related technologies successfully. Although the majority report endorses the opinion of an adviser that "recent scientific analysis of actual trends …. strongly suggests that worst-case IPCC projections are being realised", ACT has not seen any evidence that the IPCC projections anticipated the lack of warming in this decade to date while emissions have grown strongly.

Consider the impact on the New Zealand economy and households of any climate-change policies, having regard to the weak state of the economy, the need to

safeguard international competitiveness, the position of trade-exposed countries, and the actions of competing countries

The analysis presented to the Government suggests that achieving a 10 percent reduction on 1990 levels by 2020 would reduce income per person in that year by $1,400. Summed over 4 million people that is almost $6 billion a year.

ACT does not believe that New Zealanders at large would be prepared to incur costs of this order for no demonstrable benefits. The threats of adverse international action would have to be much greater than they appear to be currently to warrant the acceptance of such costs.

Moreover, the NZIER and Infometrics modelling takes no account of the Government's primary economic goal of achieving per capita income parity with Australia by 2025. The higher growth rate that this will require implies higher emissions and a greater cost of meeting the "10 percent below 1990" emissions reduction target. This scenario should be analysed as part of the regulatory impact statement.

Examine the relative merits of a mitigation or adaptation approach

New Zealanders can choose whether to mitigate, and the regulatory impact case for Government action has yet to be made.

Non-adaptation to real adverse events is not an option. New Zealanders have always had to adapt and respond to global events, particularly those that affect overseas markets, world peace, and communicable diseases. We have always had to anticipate and respond to natural disasters.

In fact, New Zealand already has, in the view of at least one authority, a world best-practice civil defence agency to deal with natural environmental hazards. It is called GeoNet. GeoNet provides evidence-based information about short- and long-term hazards like earthquakes, volcanic eruptions, tsunamis, and floods. In principle it could easily monitor underlying trends in New Zealand's temperature or sea level in order to ensure that any risks of longer-term climatic changes were identified and cost-effectively managed.

ACT considers that New Zealanders would be better informed by an agency that focused on assessing risks from trends in actual observational data rather than by NIWA, which has focused to date on making alarmist temperature projections for New Zealand based on heroic regional "interpolations" of data from unproven global climate-change models. It suggests that GeoNet could be commissioned to report on what can be said on the basis of actual evidence about climate change in New Zealand.

Currently, ACT has seen no observationally-based evidence of any warming trend in New Zealand that would be grounds for concern. NIWA accepts that New Zealand warming might be only two-thirds of any global temperature increase. Plausibly this might be beneficial for New Zealanders for many decades at least.

Consider the case for increasing resources devoted to New Zealand-specific climate change research

ACT considers that more research could usefully be done on biological and chemical ways of reducing agricultural emissions. Barring scientific breakthroughs, reducing agricultural emissions while maintaining production levels would be very difficult.

ACT also considers independent research needs to be done on temperature and sea-level trends. NIWA has acted too much as if it is the New Zealand branch of the IPCC. Governments cannot rely on one source of advice on matters of such importance. The Government should commission independent expert assessments of the margin for error in NIWA's projections of New Zealand's temperature out to 2080 and further. Those assessments should be used to revisit the guidance being given to local authorities about likely future climate changes.

Above all, ACT considers that the issue of whether New Zealanders would be likely to regard themselves as better off or worse off from moderate warming needs to be assessed. Otherwise, New Zealand's international negotiators are simply "flying blind" on whether they should be urging other countries on with mitigation, or holding them back.

Examine the relative merits of an ETS or a tax on carbon or energy as a New Zealand response to climate change

Many submitters to the select committee favoured a carbon tax. Internationally, expert economists widely favour a carbon tax.

Between the two options, ACT favours a carbon tax coupled with an equivalent subsidy for carbon sinks, and reductions in income taxes. It does so primarily in order to preserve incentives to invest in energy-intensive industries in New Zealand (for a given average level of carbon tax). Prices for units internationally under an ETS have been very volatile and greatly influenced by non-transparent political decisions. A period of unexpectedly high prices for an ETS could destroy the viability of some New Zealand firms or industries, even if the average price over a longer period of time were no higher than the average rate of a carbon tax during the same period. For example, ACT understands that unless it were exempted, New Zealand Steel would face a $20-million annual impost from a $10/tonne tax. It is easy to imagine an overseas (or domestic) owner deciding to pull the plug on a New Zealand operation that had a period of major losses under an ETS. Proponents of an ETS assert that firms could use future contracts to hedge against this risk. However, such markets might not exist and a carbon tax could achieve the same purpose without the need for firms to incur the transaction costs and counter-party risks associated with hedging. So this response effectively concedes the investment argument in favour of a tax.

A tax would also avoid the costs associated with setting up a market in emissions units. It might also lend itself less to fraud or corruption associated with the allocation of emissions units. If the tax were administered by the Inland Revenue Department, one could be more confident that such pressures could be resisted.

None of this is novel. There is widespread agreement among top economists that a carbon tax is a superior mechanism. Former US Chairman of the Council of Economic

Advisors, Greg Mankiw, has recently written that "A carbon tax is the remedy for climate change that wins overwhelming support among economists and policy wonks".

A number of Governments have implemented carbon taxes. The attachment of others to trading regimes is often for political reasons—because they are unwilling to impose the same level of tax by transparent means.

Arguments against a tax are commonly invalid. Like an ETS it is a market-oriented mechanism.

Since an ETS system—if fully adhered to—provides greater certainty about the achievement of a quantity target, the proponents of an ETS commonly propose that achieving the quantity target is more important than price certainty. However, any quantity target for New Zealand is arbitrary and any errors in setting it cannot conceivably affect global warming. Moreover, under the system being designed, an ETS does not determine the quantity of New Zealand emissions any more than a carbon tax would. This is because the designed ETS would allow New Zealanders to exceed the domestic target at will by purchasing emissions units offshore. In practice under either arrangement, Governments would have to adjust emission quantities or the level of carbon tax through time if they want to achieve a domestic emissions target. Either way, achieving an emissions target will be a trial and error matter.

ACT questions the Minister for the Environment's hypothesis that an advantage of an ETS is that prices will be low during an economic downturn and higher when the economy is buoyant, and thus cushion economic activity. If Governments really thought this was a good thing they could adjust tax rates pro-cyclically. But in practice fluctuations in global or domestic unit prices will be influenced by many other considerations, and business cycles in New Zealand may not correspond with business cycles overseas. The economy will adjust more smoothly if firms and households are faced with a stable price of carbon under a tax than volatile prices under an ETS. There is also a political advantage in terms of the acceptability of the scheme if households and businesses do not have to be nervous about the cost they will face.

Officials correctly observed that under both a carbon tax and an ETS there would be difficult measurement issues with respect to the carbon content of what is to be taxed. What they did not discuss was the option of a low-level energy tax. This option would be much simpler and avoid those difficulties.

Officials proposed two other reasons that they saw as tending to favour an ETS. One was that other countries are moving in that direction. However, some have carbon taxes, and a carbon tax can be transformed into an ETS if a deep international trading market develops. This was acknowledged in the NZIER/Infometrics report and was the recommendation of the Productivity Commission in Australia. We were advised that it would not be problematic for New Zealand to adopt a carbon tax even if Australia stayed with an ETS. ETS regimes are often favoured for political reasons (because their tax effect is disguised).

The other reason suggested as favouring an ETS is that it would confront our businesses with an emissions price that is "in tune with the economic climate that they, and their competitors, face". This is akin to the fallacious argument New Zealand should subsidise

agriculture because the EU subsidises agriculture. A carbon tax should be set at a level that achieves New Zealanders' objectives, not someone else's.

Consider the need for additional regulatory interventions if a price mechanism is introduced

The simplest approach for New Zealand, if there is a need to be seen to be playing our part, or because of trade or international relations concerns, would be to plan conditionally to introduce a low-level energy tax. Depending on what other countries are doing, there may be no need to pad this out with other measures. Regulatory measures such as energy efficiency or home insulation policies are more distorting than market-based mechanisms (a tax or an ETS). In effect they create a series of different carbon prices in the economy.

Consider the timing of introduction of any New Zealand measures

Because New Zealanders would be likely to benefit from moderate warming and there is no real evidence that even this amount of warming will occur, New Zealanders are unlikely to be willing to take early measures.

The only course of action that New Zealanders overall are likely to support would be action that is necessary for New Zealand as a member of the international community. That is why the timing of any material action by New Zealand should depend on the timing of action by the countries in the world that are large enough together to really make a difference. It is still too early to predict with any confidence if this will occur. New Zealand should await the outcome of the Copenhagen Conference and final Australian decisions before making its own plans.

Concluding comments

The foundation for good regulatory policy is a thoroughgoing analysis of the issues and available options. Much time is being wasted because officials have not been required to present politicians with such an analysis. Politicians thereby lack a sound basis for evaluating options and reaching decisions. Flawed analysis and idiosyncratic rushed decisions lay behind the previous Government's ratification of Kyoto and its promotion of the fundamentally flawed existing ETS legislation.

This is a big issue for New Zealand and unless we get it right, New Zealand's chances of achieving income parity with Australia by 2025 will likely disappear. ACT's strongest recommendation is that the Government insist on a sound regulatory analysis by officials.

ACT disagrees with many particular aspects of the majority report. In particular, it considers:

- It is wrong to treat the IPCC as an impartial authority. Its flaws have been documented by reputable inquiries and no entity has a monopoly on wisdom.
- The proposition that IPCC's worst-case scenarios are being realised seems to be inconsistent with the lack of warming in the current decade to date, while emissions have grown strongly.

- The statement that it is generally accepted by the global community that likely global warming affects would be "unacceptable" even if global emissions peak before 2015 and fall almost to zero by 2100 appears to rest on a blind belief that the few who control the IPCC constitute the global community. In fact it is voters not scientists who will determine what costs are acceptable and the IPCC does not speak for the 30,000 who signed the above petition. The majority's claim that the IPCC assessments reflect a consensus is untenable.
- Uncertainty can be a valid reason to delay action, particularly when waiting can produce future information and new technologies might reduce the cost of action. Regardless, actions need to be justified on the basis that likely benefits from action exceed the costs.
- It is wrong to argue that a carbon tax approach cannot allow foresters to manage price risks over time. A carbon tax on emissions would be combined with a carbon subsidy for (genuine) absorption.
- It is premature in assuming that the rest of the world will move to emissions trading when the EU experience with it has been so unsatisfactory. Other countries trying to put one in place are struggling with the difficulties, some other countries are taking a different approach, and the weight of expert economic opinion seems to favour a carbon tax.
- It is also premature to propose that the critical objective for New Zealand's mitigation decision should be to prepare for the continued existence of a carbon-constrained world. As our analysis above has shown, the only plausible benefit for New Zealanders from mitigation currently is that it might induce others to look more favourably on New Zealand.
- The finding that a mix of mitigation policies "will be necessary" for New Zealand illustrates the ill-justified calls for action that can be expected from the lack of a proper regulatory analysis of the issues. The majority report makes no case that other countries will look more favourably on New Zealand if we inflict a range of distorting ad hoc measures on the New Zealand economy. Officials must be required to make best-endeavours estimates of these postulated benefits.
- We agree that New Zealand should be seen to be willing to play a part in any fully international effort to reduce global emissions. A low-rate carbon tax and subsidy scheme is a more appropriate initial step, with any advance from there dependent on the advance of scientific knowledge and on a fully international effort to reduce.