Submission

By

THE NEW ZEALAND INITIATIVE

to Parliament's Environment Committee

on the

Crown Minerals (Petroleum) Amendment Bill

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1. SUMMARY AND RECOMMENDATION

In this submission, the New Zealand Initiative recommends that the Crown Minerals (Petroleum) Amendment Bill should not proceed for two reasons. First, the shocking policy development process undermines the government's credibility as a decision-maker. That needs to be put right. Second, on the evidence, the legislation's likely costs greatly exceed any benefits to the community. Other policies could deliver far greater environmental benefits at less cost.

The Government can re-establish some confidence in its decision-making processes by abandoning the Bill and restarting its policy development using a proper, deliberative and consultative process that puts the wellbeing of New Zealanders first.

2. INTRODUCTION AND BACKGROUND

This submission by the New Zealand Initiative is on the Crown Minerals (Petroleum) Amendment Bill.

The New Zealand Initiative is a Wellington-based think tank that helps develop sound public policies for a competitive, open and dynamic economy and a free, prosperous, fair and cohesive society. It is funded by members who are primarily chief executives of major New Zealand businesses. In total, these businesses employ more than 150,000 New Zealanders.

In recent years, we have published research reports stressing the need to free up the regions from the ill-justified constraints imposed on their economic development by Wellington. In particular, resource-rich regions do not need to be in economic decline.[1] Other reports have stressed the need to facilitate productivity growth to improve future wellbeing.[2]

A recurring theme is the need for better value-for-money disciplines in government when regulating and spending. Poor processes impair confidence in government decision-making. Poor processes lead to decisions that make communities poorer.

The New Zealand Initiative recognises a role for government action in response to externalities associated with climate change and supports actions in pursuit of improved environmental outcomes and well-being for New Zealanders.

In preparing this submission, we have looked at the Disclosure Statement and the Regulatory Impact Assessments associated with the Bill.

3. THE DECISION-MAKING PROCESS

Based on media reports and published information, the government's decision-making processes was close to as bad as might be imaginable in a stable democracy. As far as we are aware there was no meaningful public consultation, no in-depth public sector analysis, no regulatory impact

[1] See: "Poverty of Wealth: Why minerals need to be part of the rural economy" (2014), "From Red Tape to Green Gold', (2015), "In the Zone: Creating a Toolbox for Regional Prosperity", (2015), and "The Local Formula: Myths, Facts & Challenges", (2015)

[2] Guarding the Public Purse: Faster Growth: Greater fiscal discipline", (2014), "The Case for Economic Growth", (2015), "Welfare, Work and Wellbeing: From benefits to better lives", (2017), and "Fit for Purpose?. Are Kiwis getting the government they are paying for?

statement;[3] and no proper prior Parliamentary debate. It is not even clear to what degree MPs in the governing parties had an opportunity to participate in the decision.[4]

The quality of the Government's process is so poor that it may have signalled risks to security of property in New Zealand. Investment is sensitive to such matters because even small changes in expectations of government taking has affects the returns on assets, particularly when they are long-lived. Long-lived assets include renewable generation, electric vehicles and housing assets, and in each of these areas the Government's policies depend in part on being attracting investment. The sharp fall in the dollar immediately following the announcement suggests an impact beyond the affected industry.

The Government has the opportunity to undo much of the damage by reversing its decision and starting afresh using a sound process. There is no substitute for competent analysis and consultation before decisions are made.

4. THE POLICY

The first step in a decision process is to determine the problem that needs to be addressed. The Ministry of Business, Innovation and Employment's (MBIE) regulatory impact statement of 3 September 2018 identified the problem as perceived by the government as to "show global leadership by demonstrating to other countries that New Zealanders can be better off while taking action to reduce our impact on the climate".[5]

The difficulty with the policy is that it achieves none of these things: it will make New Zealanders unambiguously worse off, under a strengthened ETS it will not reduce domestic emissions, and as MBIE noted in its September 2018 RIS, it is likely to increase global emissions. It would be unwise and unwelcome for other countries to follow New Zealand lead on policy this poor.

The Emissions Trading Scheme (ETS) will have increasing force in the regulation of domestic Greenhouse Gas (GHG) emissions, as indicated in a recent Government consultation document.[6] As the ETS cap on emissions becomes binding, domestic emissions will be determined by the supply of New Zealand Units.[7] Proposed changes to the ETS are likely to occur within the timeframe for emission reductions through the Crown Minerals (Petroleum) Bill. Given a binding ETS cap, any reduction in GHG emissions in one sector will simply release emission credits for use in other sectors, for no overall change in domestic emissions.

The policy has the potential to shift production from New Zealand to other countries with less rigorous environmental controls. If methanol currently produced using New Zealand natural gas were instead produced using coal-based technologies in China, it is far from inconceivable that total GHG emissions could increase. If coal-based production generates greater GHG emissions per unit of methanol produced, and if caps on emissions in China are expected to be less binding than caps are expected to be here, then increases in total emissions become more likely than not.

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[3] The Bill's explanatory note reports that the Ministry of Business, innovation and Employment produced a regulatory impact statement on 3 September 2018. Cabinet's key decisions were taken much earlier.

[4] An article in The Initiative's *Insights* newsletter, 22 June, "Sovereign Risk and the Divine Right to Rule – At a whim", enumerated some of the apparent deficiencies in the decision-making process.

[5] Available from https://www.mbie.govt.nz/info-services/sectors-industries/natural-resources/oil-and-gas/overview-crown-minerals-act-regime/pdf-document-library/regulatory-impact-statement-proposed-changes-to-the-crown-minerals-amendment-act-1991.pdf

[6] Ministry for the Environment (2018), "Improvements to the New Zealand Emissions Trading Scheme", available from https://www.mfe.govt.nz/publications/climate-change/improvements-new-zealand-emissions-trading-scheme

[7] For those parts of the economy covered by the ETS.

Prices should always be preferred to bans as least-cost ways of reducing emissions. Evidence suggests abatement using command and control occurs at a far higher social cost per tonne of GHG emissions than market-based measures such as ETS or carbon taxes.[8] If the cessation of natural gas production is the least-cost way of reducing GHG emissions, then that is the solution that will be found by tighter ETS cap. But if other ways of reducing emissions were more effective, those solutions can be discovered and exploited by market-based instruments such as an ETS but precluded by regulatory measures targeting particular industries. Inevitably, forgoing of the use of market discovery for command raises the cost of abatement. It is only New Zealand's small scale, and the fact that the policy will entirely be undone by leakage to overseas sources, that prevents this policy having more serious human and environmental consequences.

Banning natural gas exploration in Taranaki seems exceptionally unlikely to be the lowest-cost way of reducing total emissions in New Zealand. Consequently, New Zealand will be doing far less good than it could be doing in reducing total global emissions. If the government chose instead to devote similar effort to improving the ETS and making the cap binding, participants in the market would find the least costly ways of achieving the government's objective.

4. THE IMPACT ON COMMUNITY WELLBEING

MBIE's September 2018 regulatory impact analysis found that between 2027 and 2050, the undiscounted fiscal cost to government of the proposed measures could be of the order of $16.6 billion in 2018 dollars. For petroleum companies, the cost could be (a further?) $19.2 billion.[9] Unfortunately, MBIE does not assess the net cost to community wellbeing.

These calculations understate the likely loss of community wellbeing because they do not compare the Bill's measures with the least-cost way of achieving emissions reductions (see section 3 above).

Far from reducing New Zealand's impact on the climate or achieving a transition to a lower emissions economy, the primary effect of the Crown Minerals (Petroleum) Bill will be to shift royalty payments and corporate taxes worth hundreds of millions of dollars each year into the coffers of governments overseas. In exchange, as already noted, the policy will achieve no substantial reduction in domestic emissions or progress towards a goal of net zero emissions in 2050. Without any significant merits, it is unclear how this policy could bear scrutiny in any proper policy process.

We are aware of the argument that banning efficient sources of energy would stimulate innovation in adopting inferior substitutes.[10] Innovation is important in reducing carbon emissions and in mitigating the effects of any global warming or associated rise in sea level. However, while a New Zealand ban on exploration will not increase innovation, evidence from Europe suggests the pricing of carbon through the ETS has had a significant effect in lifting innovation rates.[11]

5. CONCLUSION

Given the government's goal of demonstrating global leadership in reducing GHG emissions, and the advantages of market-based abatement over command, a superior approach is to accelerate

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[8] A study by the OECD in 2013 found the per-tonne cost of abating CO2 emissions was five times higher for regulation than via emissions trading. Available from https://www.oecd-ilibrary.org/taxation/taxing-energy-use_9789264183933-en

[9] Eric Crampton commented on MBIE's analysis in Insights, 28 September 2018, "Celebrating Sisyphean Labours". Michael Reddell has also blogged on this at Croaking Cassandra.

[10] This is a variation of the nineteenth century French writer Frederic Bastiat's broken windows fallacy. By destroying windows, replacement production can be simulated, apparently generating jobs and income.

[11] Dechezleprêtre, Martin and Bassi (2016) show that the effect of the EU ETS on innovation activity followed an increase in permit prices to approximately €30 per tonne of carbon dioxide. This, combined with an expectation that prices would remain at a high level in the foreseeable future, increase the rate of innovation. See http://personal.lse.ac.uk/dechezle/Dechezlepretre-et-al-policy-brief-Jan-2016.pdf

strengthening the ETS and setting a path towards tighter caps on aggregate emissions. Other countries could draw lessons for their own systems of emissions trading.

In view of the current approach, our fear is that the lesson other countries might instead take is that policies for GHG mitigation carry substantial economic and political costs, risk for the national reputation, and consequences for affected communities, like Taranaki, which in combination make emissions reduction infeasible.

In its current form, the Bill undermines the government's credibility as a decision-maker and reduces community wellbeing.

In view of the predictable and inevitable consequences of this policy for the environment and for national income, the New Zealand Initiative recommends the Bill be withdrawn, the policy abandoned, and a proper process aimed at developing cost-effective measures for reducing GHG emissions commenced.