Submission

By

THE NEW ZEALAND INITIATIVE

To the Commerce Commission

on its open letter

Ensuring our energy and airports regulation is fit for purpose

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INTRODUCTION AND SUMMARY

Thank you for the opportunity to provide feedback on the Commerce Commission's open letter about ensuring our energy and airports regulation is fit for purpose (29 April 2021).

The New Zealand Initiative is a Wellington-based public policy think tank. We are an independent organisation supported by corporate and private donors.

Human-induced emissions of greenhouse gases cause anthropogenic climate change. The New Zealand Initiative supports the commitment to lower emissions and the emissions targets agreed by Parliament. The question now before us is how to achieve those targets.

New Zealand's emissions targets are ambitious. However, as the Climate Change Commission showed in its draft emissions budget, we have choices about how and where to reduce emissions. An appropriate objective for choosing between alternatives is cost minimisation. That objective is consistent with delivering emissions targets for the smallest losses of wellbeing. The test of emissions policies is that they reduce emissions genuinely and cost-effectively.

The emissions problem can be thought of as the discovery of the highest-value use of scarce emissions rights over time subject to political feasibility. The Commerce Commission will recognise this as a dynamic efficiency problem. Accordingly, any solution to the emissions problem must be credible and rules-based.

The Commission's expertise and experience in competition policy has direct application to the emissions problem. The opportunity in this review of its Part 4 responsibilities is for the Commission to demonstrate to other agencies the rigorous application of an economics and competition framework to emissions reduction.

Our submission focuses on the emissions component of the Commission's review. At this early stage of the review, our submission emphasises good public policy practices, including clear problem definition and the use of cost-benefit analysis. The Commission must recognise the interaction of the ETS with other policies as it considers changes to Part 4.

We support the Commission's focus on removing barriers and welcome its reference to least-cost energy services.

ORGANISING FRAMEWORK

Climate change policy should aim to reduce net emissions for the least-cost i.e. the smallest loss of long term wellbeing, subject to (i.e. constrained by) political feasibility. This objective is consistent with the Commission's purpose of promoting competition in markets for the long-term benefit of consumers. A least-cost objective can serve as an organising principle for the emissions component of the Commission's Part 4 review.

If cost minimisation is not an acceptable objective, the Commission should specify its preferred objective and show that the objective is consistent with the long-term benefit of consumers. New Zealand's emissions targets are ambitious, which means it is not possible to ignore costs entirely without putting those targets in jeopardy.

Regardless of the Commission's preferred objective, once emissions rights are established then concepts of markets, competition, and efficiency become relevant. The emissions problem is the discovery of the highest-value use of increasingly scarce emissions rights over time. This is a dynamic efficiency problem.

The dynamic nature of the emissions problem helps identify the features we should expect to see in any policy approach. Solutions should be rules-based and support decentralised decision making. Emissions rights must be well-specified and capable of being limited in line with emissions targets. Both the system and the chosen emissions targets must be credible.

Competition for the use of limited emissions rights can discover the highest-value use of those rights. As far as possible, competition should be on a level playing field, meaning equal treatment of emissions rights including a single price for those rights.

In principle, cap-and-trade schemes including the New Zealand ETS meet these requirements, as do carbon taxes.

THE EMISSIONS TRADING SCHEME

The ETS includes all Part 4 companies. The ETS covers emissions from electricity and gas, and partly covers airport emissions, since international flights are excluded.

With respect to emissions, the Commission's review must be based on a correct understanding of how the ETS interacts with other policies.

The ETS is designed to cap emissions from its area of coverage in the economy. *In principle*, a binding emissions cap means any reduction in net emissions from Part 4 companies will be offset[1] by higher net emissions (or less emissions reductions) elsewhere in the economy. Emissions can only be capped once, which is roughly equivalent to the competition policy idea that a monopolist can only take its profits once.

The effect of a binding emissions cap, in principle, is to create a wedge between the emissions benefits of policies with respect to Part 4 companies and emissions benefits overall.

In practice, the ETS cap may not be fully effective due to various imperfections. For example, the ETS's long term effectiveness substantially depends on its credibility, which is uncertain. However, even if the ETS is only partly effective so that emissions cuts from Part 4 companies are only partially offset by higher emissions elsewhere in the economy, the ETS cannot be ignored entirely. Even a soft emissions cap could plausibly damp more than 50% of the emissions benefits of any changes to Part 4. Even an imperfect ETS should not be excluded from any case for change.

The ETS does not neutralise other policies where those policies apply outside the ETS' area of coverage.

PROBLEM DEFINITION

If the ETS (including an imperfect ETS) drives a wedge between emissions benefits from Part 4 companies and emissions benefits overall, then the Commission's definition of what counts as an emissions benefit becomes important to any case for changes to Part 4. We suggest the Commission define emissions benefits in a way that is consistent with progress

[1] Throughout this submission, "offset" refers to changes in both reductions and removals of emissions which counteract net emissions changes elsewhere.

towards emissions targets. New Zealand's emissions targets are defined at a national, not sector, level. Accordingly, we recommend the Commission define benefit emissions benefits from any changes to Part 4 based on changes in overall emissions.

The risk of defining emissions benefits only for Part 4 companies is that costly reforms could be undertaken for no progress towards emissions targets. Based on a narrow definition of emissions benefits, a siloed approach is likely to force emissions reductions through high cost channels, raising the overall cost of achieving emissions targets.

In the interests of reducing emissions and achieving our targets at least-cost, we urge the Commission to define emissions benefits based on changes in overall emissions.

THE STATUTORY TARGET IS NET EMISSIONS

While we accept the Commission will use language that is consistent with other government agencies, we urge caution. The Commission should recognise "decarbonisation," "energy transition" or a "low carbon economy" as inconsistent with New Zealand's statutory emissions targets.

The Climate Change Response Act, as amended by the Zero Carbon Bill in 2019, sets a 2050 target based on net emissions of long-lived greenhouse gases. The 2030 target based on the Paris climate agreement is also a net emissions target.

The distinction between the quoted terms and our statutory targets has practical importance. Read literally, the quoted terms pre-empt how and where net emissions can be reduced most effectively. The terms tend to emphasise reductions in gross emissions, which can substantially raise the cost of reducing net emissions where removals by trees and other technologies are cost-effective. "Energy transition" implies some expectation of reductions from specific sectors regardless of comparative cost-effectiveness, contrary to a least-cost approach to lower net emissions.

If the distinction seems academic, we urge the Commission to consider the consequences of gross rather than net emissions targets. In its draft report earlier this year, the Climate Commission found current policies can achieve net zero emissions with an ETS price of $50 in 2050. The Climate Commission's plan achieves the same emissions targets but at a far higher carbon price of between $250 and $860 per tonne in 2050. This 5- to 16-fold increase is the product of a targeting gross rather than net emissions.

We urge the Commerce Commission to act consistently with our statutory emissions targets as they are worded in the legislation. Terms like "decarbonisation," "energy transition" and "low carbon economy" are not consistent with our statutory targets.

RECOMMENDATIONS

We recommend the Commerce Commission:

- Declare an objective, with respect to emissions, to reduce emissions at least-cost.
- Define emissions benefits according to changes in overall emissions, not Part 4 companies in isolation.
- Use cost-benefit analysis to assess any proposed changes to Part 4.

- Develop a framework which recognises the interaction between the ETS and other policies, including an imperfect ETS, then use this framework in any cost-benefit analyses.
- Pursue net emissions reductions, consistent with the statutory target.

Thank you for considering this submission.

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