

**Submission**

**By**

**THE  
NEW ZEALAND  
INITIATIVE**

**to the Environment Committee**

**on**

**The Emission Reduction Plan**

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# 1 INTRODUCTION AND SUMMARY

- 1.1 This submission in response to the Emissions Reduction Plan is made by The New Zealand Initiative (the **Initiative**), a Wellington-based think tank supported primarily by major New Zealand businesses. In combination, our members employ more than 150,000 people.
- 1.2 The Initiative undertakes research that contributes to the development of sound public policies in New Zealand and the creation of a competitive, open and dynamic economy and a free, prosperous, fair and cohesive society. The Initiative has produced several reports and submissions on climate policy.<sup>i</sup>
- 1.3 The Initiative's members span the breadth of the New Zealand economy, including many directly affected by the Emissions Reduction Plan. The views expressed in this submission are the views of the author, not those of our members.
- 1.4 Our submission supports the Zero Carbon Act's goal of attaining net zero by 2050. We urge a greater focus on the Emissions Trading Scheme, enabling carbon prices to do more of the work in getting New Zealand to Net Zero, and avoiding policies that put net zero at risk by forcing higher-cost emission reduction strategies.
- 1.5 In summary, we submit:
  - (a) Reducing the quantity of ETS credits that the government issues each year is sufficient to achieve net-zero within the sector covered by the ETS;
  - (b) Policies other than the ETS affecting the covered sector fall into three broad categories.
    - a. Some policies address real and material non-carbon market failures, or ease policy impediments to adapting to higher carbon prices. Those policies are *enabling*: they help the ETS to work more effectively, getting New Zealand to net zero at lower overall cost. Easing regulatory constraints against importing and using building materials as part of lower-carbon building solutions would be one example, as would shifting electric vehicles into the Road User Charge system to ensure ongoing sustainability of the National Land Transport Fund. Or, if uptake of electric or hydrogen-powered vehicles were hindered by lack of charging or fuelling stations, and provision of those stations were not economic without a larger user base, government could consider temporary subsidies for charge-point provision to avoid chicken-and-egg issues. *Enabling* policies should be encouraged where cost-effective. The Tinbergen Rule applies: while a carbon price is highly effective in addressing the global externality imposed by greenhouse gas emissions, other policies are needed to solve other problems that may be discovered along the way.
    - b. Other policies respond and adapt to the consequences of rising carbon prices. For example, a council may anticipate greater demand for public transit when carbon prices are higher and seek to accommodate that demand through revised local transport offerings. These *responsive* policies should also be encouraged where cost-effective: they encapsulate exactly the behaviours that carbon prices are intended to encourage.
    - c. Other policies seek to reduce emissions in the covered sector more directly by mandating how and where emissions should be reduced. These *complementary* policies will have a difficult time reducing national net emissions in sectors covered by the ETS's cap on emissions. They risk simply freeing carbon credits for others to use instead. The government can reduce the ETS cap in conjunction with complementary policies. But if those policies are not cost-effective, the country

would be better off overall if the ETS cap were reduced without the complementary policy. Consequently, *complementary* policies should not be pursued unless accompanied by compelling evidence that regulatory measures deliver emission reductions at far lower cost-per-tonne than could be achieved by simply reducing the ETS cap more quickly. Examples include Regional Councils including carbon emissions as part of consenting processes, clean car rebates and EV subsidies, food waste collection mandates, and too much of the substantive content of the Emissions Reduction Plan.

- (c) A greater reliance on the Emissions Trading Scheme, in combination with *enabling* and *responsive* policies, and rigorous cost-effectiveness assessment of any *complementary* policies directly targeting emission reductions within the covered sector, provides the most promising mechanism for achieving net zero.
- (d) Taking equity considerations seriously matters in ensuring ongoing political support for rising carbon prices. The most promising way of mitigating inequities caused by rising carbon prices, at least through the medium term, is by implementing a carbon dividend that returns to households any revenues earned by the government because of rising carbon prices. The transfer would prove highly progressive, and can help lock in support for rising carbon prices where the typical household would receive more as a carbon dividend than it pays in carbon charges indirectly through the ETS.
- (e) The Emissions Reduction Plan includes a host of activities that are, at best, tangential to achieving net-zero. In too many places, the document appears to be a party-political manifesto claiming a wide variety of policy objectives, including an income insurance programme, are critical as part of emissions reduction and meeting net-zero targets. The Government could ask itself what it would think if some future National-ACT government, sometime between now and 2050, abolished unions as part of a future Emissions Reduction Plan. That future government could claim that labour market flexibility is needed to allow industry to adjust to rising carbon prices, while putting union-breaking into the ERP. It is rather unlikely that a future alternative government would do this. But putting substantial parts of the Government's policy agenda, of tangential relevance to carbon emissions, into the Emissions Reduction Plan does disservice to the cross-party consensus that supported the Zero Carbon Act. More importantly, it does not help New Zealand reach net zero.

## **2 TAKING NET-ZERO SERIOUSLY: THE BIG PICTURE**

2.1 Getting to net zero poses substantial real and political challenges.

2.2 Rising carbon prices as the ETS cap tightens will encourage large cumulative changes in sectors where net emission reductions are cost-effective. There will be real technical challenges for policy in ensuring proper accounting for things like soil carbon sequestration; in setting regimes for carbon capture and storage; in coordinating internationally on carbon-equivalent tariff systems that avoid turning into protectionist regimes; and a host of issues that we will only discover as they emerge over the next three decades.

2.3 The real changes that come in response to higher carbon prices, combined with distributional effects of rising carbon prices, also bring political risk. A sustainable path to net zero must be politically durable across changes in government between now and 2050 – and beyond.

- 2.4 Meeting these challenges requires a sharp focus on finding the most cost-effective ways of reducing net emissions. If government chooses pathways for achieving net zero that are more costly than necessary, the compounding cost over years risks voter backlash that puts the target in jeopardy.
- 2.5 At a high level, New Zealand has much of the policy apparatus already in place to enable the country to successfully reach net zero by 2050.
- 2.6 A comprehensive Emissions Trading Scheme covers emissions outside of agriculture; agricultural emissions will start being priced to bring methane emissions to more sustainable levels.
- 2.7 The ETS caps net emissions. Net emissions within the covered sector, in any year, cannot exceed the sum of carbon credits issued that year and previously purchased credits that have not yet been redeemed. The sum of outstanding credits and currently issued credits forms a cap on net emissions.
- 2.8 The ETS includes a price cap mechanism in which some budgeted units that had been withheld are released if carbon prices reach trigger levels, and in which further 'backed' units are released at the price cap. These units must be 'backed' by net reductions elsewhere, although the mechanism supporting backing could be strengthened.
- 2.9 Given that starting point, getting to net zero could be straightforward. Government could make the cap binding over time by specifying the quantity of net emissions that is acceptable along the path to 2050, subtracting the number of outstanding ETS credits from that pool, and requiring that any year's issuance of unbacked credits is drawn from the remaining pool. Indicative guidance could suggest government's intentions around annual carbon permit release. But the overall pool would be more important.
- 2.10 The current price cap mechanism could be updated to strengthen its backing provisions while providing a stronger safeguard against New Zealand carbon prices falling out of line with international carbon prices. Instead of picking a price for the price cap, the system could set the price cap to be equal to a volume-weighted average of international carbon prices in Emission Trading Schemes that the Climate Commission deems credible. Effectively, New Zealand's carbon price cap would be pegged at a level slightly below Europe's as European carbon markets would be influential in any volume-weighted average. Units purchased on those international markets could back units released into the New Zealand market at the price cap. This would provide immediate backing of units released at the price cap. It would also avoid potentially substantial economic costs if carbon prices in New Zealand, under a declining ETS cap, ever exceeded carbon prices in places like Europe.
- 2.11 The government earns substantial revenue at ETS auction. Those funds have been hypothecated to climate-related purposes. They could be used to far more directly address distributional consequences of rising ETS prices while enabling households to effect their own just transition.
- 2.12 New Zealand could follow Canada in providing a carbon dividend that rebates government carbon revenues back to households. An even-split redistribution of

carbon revenues among 5.1 million Kiwis would constitute a progressive transfer. Carbon and carbon charges are embodied in many goods and services; richer households spend more money on all goods and services, carbon included. Richer households pay more in total in carbon charges; an even split of revenues so-raised would result in most households receiving more in carbon dividends than they pay in carbon charges.

- 2.13 Canadian Environment Minister Steven Guilbeault recently reminded Canadians that “eight out of ten households in Canada are better off – they receive more money from our carbon price.”<sup>ii</sup> Modelling by Adolf Stroombergen at Infometrics for the Citizens’ Climate Lobby suggests a New Zealand carbon dividend would be similarly progressive.<sup>iii</sup>
- 2.14 Because New Zealand has adopted an ETS rather than a carbon tax, a carbon dividend could only provide a transitional payment helping households as they adjust to a higher carbon-cost future. When the government ceases auctioning carbon credits, it will cease generating revenues that could fund a carbon dividend. The dividend could help ease this transition, empowering households to make the investments that they see as relevant to their own circumstances – whether an e-bike, more insulation, heat pumps, a lower emission hot water system, or another option entirely.
- 2.15 At least over the medium term, a carbon dividend could help solidify political support for rising carbon prices while funding households’ transitions.
- 2.16 Under this kind of approach, rising ETS prices would guide behaviour while the ETS caps net emissions. Households and businesses would have strong incentive to find the most cost-effective ways of reducing net emissions. Individuals may make mistakes, either responding too vigorously or not vigorously enough to the signals provided by rising prices, but net emissions would not be affected. Under a binding ETS cap, those kinds of errors can affect the price of carbon credits but cannot affect net emissions. The cap sets net emissions.
- 2.17 Additional enabling policies would still be necessary for addressing other market and policy failures that would otherwise result in a costlier path to net zero than is necessary.
- 2.18 The Initiative’s submission on managing exotic afforestation incentives noted the importance of applying Tinbergen’s Rule to carbon.<sup>iv</sup>
- 2.19 Economist Jan Tinbergen, in 1952, argued that policymakers need at least as many policy instruments for affecting outcomes as they have outcomes they wish to target. When the number of targets exceeds the number of instruments being used to achieve those targets, solutions will wind up being incompatible with each other, and the set of solutions will be inconsistent.
- 2.20 The primary instrument for reducing net carbon emissions is the Emissions Trading Scheme, which is uniquely targeted at reducing net emissions.
- 2.21 Rising carbon prices can result in any number of emergent problems that had not been anticipated when the ETS was set.

- 2.22 If additional problems emerge that require addressing, Tinbergen’s Rule suggests that additional tools are needed to solve each additional problem. Attempting to solve secondary problems, like biodiversity, by modifying the primary instrument will either result in reducing the primary instrument’s efficacy in addressing its target, in far-from-adequate targeting of secondary problems, or both.
- 2.23 To put it simply, policy should not be required to hit multiple birds with the same stone. The single stone is likely to cut a path between the two birds, missing both. When multiple stones are entirely possible, multiple stones should be employed.
- 2.24 In the context of exotic afforestation, the Tinbergen rule suggests biodiversity goals are better achieved through their own direct instrument, like a subsidy for provision of biodiversity services, rather than seeking to adjust a ‘balance’ between gross and net emissions in the ETS. The principle applies broadly.

### **3 THE EMISSION REDUCTION PLAN**

- 3.1 The Tinbergen Rule specifies that if many goals are sought, many instruments will be needed to target them. The Emission Reduction Plan proposes a wide assortment of potential goals, and a host of instruments for achieving them. But many of these goals, some of them worthy, seem rather tangential to achieving net zero. And too few proposed policies seem rigorously assessed for cost-effectiveness.
- 3.2 Worse, the Plan is too often prescriptive of specific strategies that should be followed by councils and others for reducing emissions, rather than allowing them to be guided by rising emission prices.
- 3.3 As a far-from-comprehensive list, the Plan suggests decarbonising regional transport, development of circular economy strategies, waste minimisation, job transition programmes, tailored support to small and medium-sized enterprises, changes to NCEA to encourage “an understanding of the collective nature of our wellbeing and learning”, a Green Investment Finance fund, behaviour change campaigns to avoid organic waste and more.
- 3.4 While the Plan highlights the importance of equity and just transitions, it ignores options like a carbon dividend in favour of in-kind assistance provided through government programmes – whether retraining, or subsidies for some kinds of lower-carbon investments, subsidised public transit schemes, or income insurance and welfare schemes.
- 3.5 It is difficult to see how and where the Emissions Reduction Plan has considered how its various proposals interact with the Emissions Trading Scheme. Measures like industrial decarbonisation subsidies will simply free up carbon credits for other sectors to use. Rigorous cost-per-tonne assessments are critical in ensuring that these programmes deliver value; if they do not, simply reducing the ETS cap more quickly would be preferable.
- 3.6 A government’s headline decarbonisation initiative, the GIDI Fund, has yet to be evaluated for cost effectiveness. In preparing this submission, I requested any evaluation or draft evaluation of GIDI-funded projects’ additionality: effectively, whether the funds simply paid companies to do things that they were already going to be doing because of rising carbon prices. EECA informed me that, to the best of their knowledge, no such evaluation has yet been undertaken. It may be advisable to make those assessments before setting an Emission Reduction Plan that is based on programmes like GIDI.

### **4 RECOMMENDATIONS**

- 4.1 We suggest that the Committee consider focusing the Emissions Reduction Plan to a narrower brief.
- 4.2 We suggest that measures undertaken within the Plan be adequately assessed for cost-effectiveness and additionality, taking into account the effects of the Emissions Trading Scheme.
- 4.3 We suggest that the Committee consider a carbon dividend as solution to equity and just transition concerns, as well as a way of locking in political support for rising carbon prices over the critical medium term.
- 4.4 Finally, we suggest that the ETS be allowed to do its work in reducing net emissions. Other policies should be used for addressing other concerns, rather than attempting to refocus and balance between gross and net emissions within the ETS.

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<sup>i</sup> These include submissions on [managing exotic afforestation incentives](#) (MfE and MPI), on [transitioning to a low-emissions and climate-resilient future](#) (MfE), on designing a [governance framework for the ETS](#) (MfE), on [transport emissions and pathways to net zero](#) (MoT), on [phasing out fossil fuels in process heat](#) (MfE), and on the [draft emissions budget](#) (Climate Change Commission). They also include [substantive reports on the Zero Carbon Bill](#) (2019), and on achieving [Net Zero and the merits of ETS-led approaches](#) (2022).

<sup>ii</sup> Environment Minister Guilbeault made these comments on CTV's "Power Play", 30 March 2022. See discussion in Eric Crampton, 2022. "[Paths to Net Zero: Carbon Dividends.](#)" *Dominion Post*. 4 April.

<sup>iii</sup> Stroombergen, Adolf. 2021. "[An Economic Assessment of a Carbon Dividend in New Zealand for Citizens' Climate Lobby New Zealand.](#)" Infometrics. March.

<sup>iv</sup> Crampton, Eric. 2022. "[Submission on the Discussion Document Managing Exotic Afforestation Incentives.](#)" The New Zealand Initiative. 22 April. Note that we here draw liberally from that submission.