



NZ ETS Review Consultation
Ministry for the Environment
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Submission to the Ministry for the Environment on “New Zealand Emissions Trading Scheme Review 2015/2016”

Horticulture New Zealand (HortNZ), along with Tomatoes New Zealand (TNZ) and Vegetables NZ Inc. (VNZI) welcome the opportunity to provide a submission to the Ministry for the Environment on the NZETS review. HortNZ and TNZ recognise that changes are required to reflect recent international climate change negotiations.

Horticulture New Zealand represents the interests of New Zealand's 5,600 commercial fruit and vegetable growers. The horticulture industry is valued at over \$6 billion annually to the New Zealand economy.

Tomatoes New Zealand is the national organisation representing New Zealand's 150 fresh tomato growers, almost all of whom grow in greenhouses. The fresh tomato industry has an annual farm gate value of \$100m.

Vegetables NZ Inc. is the national organisation representing 950 fresh vegetable growers (total gate sale value \$340m) including 128 greenhouse growers (excluding tomato growers) who produce domestic and export sales of over \$140m.

This submission comments on the following review Priority Issues:

1. Moving to full surrender obligations
2. Managing the costs of moving to full surrender obligations

The other review issues will be addressed by Horticulture New Zealand in a separate submission by the April 30th deadline namely:

1. Business responses to the NZ ETS
2. Protecting competitiveness through free allocation

3. Managing unit supply, including issues relating to international units and selling NZU's by auction
4. Managing price stability
5. Operational and technical matters
6. Addressing barriers for uptake of low emissions technologies.

BACKGROUND

The costs of energy incurred by horticultural businesses includes direct energy costs as well as those indirect costs passed on to them through the price of the inputs they purchase (packaging, fertiliser, machinery etc.), and any costs passed to them by post-harvest operators such as pack houses, cool stores, and freight companies.

For the greenhouse vegetable industry, including fresh tomatoes, capsicums and cucumbers, energy is the second highest single input cost in greenhouse expenses following closely behind wages. In climate controlled greenhouses (excluding those houses that either do not heat or only have frost control) energy costs are greater than 20% of expenses, or between 15% to 18% of revenue, making them highly vulnerable to rising energy costs and additional energy related taxes. Because the vast majority of fruit and vegetable growers sell in a commodity market, neither the direct nor indirect costs can be passed on to the consumers of the produce, instead incurring a direct net loss to the business. Growers do not have the ability to pass on any ETS cost increases on a "cost plus" basis to their customers.

As such they have been recognised under the EITE (Emissions Intensive Trade Exposed) scheme with free allocations. However, HortNZ, TNZ and VNZ Inc. are encouraged to see that the discussion document states that 'The government supports keeping the free allocation regime in place until at least 2020'¹. For the reasons explained below, the cost of carbon to many indoor growers is impossible to pass on to consumers, and will have negative consequences on the availability of New Zealand grown vegetables.

Horticulture is a commodity based business, being price takers rather than cost plus. The horticulture industry in New Zealand operates in a global market with over 60% of our production exported and we face strong competition here in New Zealand from imports from Asia particularly for processed products such as frozen vegetables and canned fruit and vegetables. Greenhouse growers in particular face direct competition with Australian product, both on the New Zealand domestic market and in the Australian market, and with product from many other countries in Asian markets.

There has been considerable talk about the ability to switch fuel sources, in particular among South Island greenhouse vegetable producers with coal boilers and the idea that they could convert to wood fuel, or perhaps waste oil. While some growers have converted, it is not an industry wide solution. For many growers the logistics of stockpiling the quantity of wood required, transporting a bulky low energy density product, resource consent requirements for storage facilities and the scarcity and inconsistency of supply precludes this as a viable option for most. The capital cost of conversion to alternative fuels is high, particularly for small and medium sized operations. In most cases there is no commercially viable alternative.

¹ Page 3, section 1.

Greenhouse growers are delaying future investment in New Zealand until there is some determination as to the future of the ETS. This is not just a South Island phenomenon, as there has been little significant investment in new vegetable greenhouse production facilities in the whole of New Zealand in the last few years, and the total area of covered vegetable production has remained stable in the past five years other than one capsicum grower who has invested in expanding their production for anticipated increased exports.

With no new production area increasing domestic food demand will likely be met by imports from countries with significantly higher greenhouse gas emitting production systems. The uncertain future of the ETS and the scarcity of capital are the key factors holding back investment in alternative technologies and any new investment in greenhouse vegetable production.

HortNZ recognises the need for a robust framework for carbon trading and the requirement for businesses to plan for a more carbon constrained future. However the fact that New Zealand does not currently have access to units on the international market and has a closed market, trading at a higher unit rate than the international rate with no agreed rules on forestry and land-use is a cause for concern. The international market places we export to either do not have schemes placing a value on carbon, or are likely to provide exemptions to their domestic growers, who are our competitors.

HortNZ represents fruit and vegetable growers with varying carbon footprints from orchards with a relatively small carbon footprint to covered crops using fossil fuel to heat. There has been a lot of work done on carbon footprinting (carbon emissions) and potential carbon sequestration and whilst this is not being considered in the current framework and is in the 'too hard basket' along with soil carbon and agricultural emissions, it is worth noting for future reference. The main focus of the discussion document is on protecting New Zealand's export based economy but horticulture is also important to the domestic market. The importance of being able to source New Zealand grown fruit and vegetables should not be overlooked, considering national nutritional health and future-proofing food security. Relying on imported produce ultimately leads to increased prices for our consumers, and almost certainly higher global carbon emissions.

QUESTIONS

1. Do you agree with the drivers for the review?

Yes – HortNZ does support the need for businesses to prepare for a more carbon constrained future to meet reduction targets and recognises that the “NZETS is the principle policy response to climate change”. However, the international context and global policy response to the climate change issues is uncertain as are the rules governing international carbon markets and access for New Zealand to those markets at affordable prices. It would be considered prudent therefore to consider longer timeframes of transition to ensure that New Zealand policy does not adversely impact our export based economy and ability to produce fruit and vegetables for the domestic and international markets.

2. What other factors should government be considering in this ETS review?

These considerations would enable New Zealand to produce reasonably priced domestic food as well as being able to meet Government's target to 'double primary industry exports in real terms from \$32 billion in June 2012 to over \$64 billion by 2025.'²

In 2012 New Zealand imported \$80 million of fresh vegetables and \$31 million of processed vegetables (see Appendix A). The ability of New Zealand's horticulture to feed New Zealand and increase exports to boost the economy depends on a multitude of factors including access to high quality soils, infrastructure, labour, power, fuel and water. The impact of policy decisions relating to the NZETS will have an effect on the profitability of horticultural businesses in different ways depending on fuel use, fertiliser use and other downstream supply chain costs that may not have been considered in the NZIER report.

HortNZ is supportive of growers improving their sustainability and lowering their carbon footprint where possible. However as a small country exposed to international competition both domestically and internationally, several factors outside of the governments control could affect the viability of the sector. These include:

- Increasing cost of domestic food if full surrender is implemented and the potential demise of domestic production where growers find they are unable to pass costs on;
- the lack of options, cost and practicality of covered crops growers moving to biofuels and the security of supply of these biofuels;
- ability to achieve government goals of doubling primary sector exports in New Zealand whilst competing with countries that have not imposed a cost of carbon

Moving to full surrender obligations

3. Should the ETS move to full surrender obligation for the liquid fossil fuels, industrial processes, stationary energy and waste sectors?

It is recognised that the one for two measure was a transitional measure and that this was never intended to be ongoing. However as New Zealand has a closed carbon market, moving to full surrender would increase the price of NZU's in a way that bore no relation to the carbon prices of our key trading partners. As mentioned in the NZIER report:

*'If by 2020 our key trading partners all adopted new climate change policies that imposed higher emissions prices, or if the world adopted a global agreement with full international trading of emissions units, both our reference case and the scenarios after the removal of the transition measures would be affected by similar amounts. That is, there would be a level shift but the change in impacts from the baseline would not be affected.'*³

² <https://www.mpi.govt.nz/about-mpi/our-strategy-2030-growing-and-protecting-new-zealand/the-export-goal/>

³ NZIER Report – Page 14

The report then goes on to say that if the one for two measure was removed as international partners are imposing more stringent climate change policies, the relative costs of NZU's would fall. As such the benefits of taking a 'wait and see' approach and being cautionary with removing the transitional measure would be wise.

It is noted that at present there are no free market principles applied to the NZU's and that access to international units has stopped. The initial intention when the scheme was developed was for international trading. Having competition is important for price moderation and one of the benefits of an ETS over a carbon tax. The closed market also creates uncertainty as the Government could intervene in the market at any time to control the supply and therefore the price of units.

The current proposal to go to full surrender will effectively raise the price of New Zealand Units, to the benefit of foresters but at the expense of our horticultural producers and our export competitiveness.

HortNZ, TNZ and VNZ Inc.'s position is that removing the transition measures while there is still a lack of international action, places an unreasonable burden on growers who are unable to pass on or reduce the costs, and the measures should be retained until there is more evidence of international alignment.

It is noted that as mentioned in the discussion document 'if the one for two surrender obligation is removed, the amount of free allocation provided to emissions intensive and trade-exposed activities will automatically be increased to correspond with the increased surrender obligation.'

- 4. What impact will moving to full surrender obligations have on you and your business?**
 - a) increased carbon prices, including actions to reduce emissions and future investment decisions. Please comment on effects that may occur at carbon prices ranging from \$5 to \$50, including evidence of actions taken previously when carbon prices were higher**

For most outdoor horticultural businesses the costs would be in the form of increasing electricity and fuel for processing, harvest and export. At this stage HortNZ has not done detailed case studies on businesses that do not have an EITE allocation but would be prepared to work with MfE to develop case studies for various sectors to ascertain the upstream and downstream costs to businesses and consumers. Based on our first look we estimate that an increase from \$5/t to \$50/t would increase grower fuel costs by approximately \$11m, (which includes \$6m for greenhouse production).

In addition fertiliser costs, particularly nitrogen, will increase in price. The impact of this hasn't yet been determined, but as an energy intensive product used by almost all growers it will be significant.

For a large greenhouse burning 1200 tonne of coal per year, the cost to the grower of the escalated price of coal (based on an ETS price ranging from \$5 to \$50) would be an increase of \$15,900 to \$159,000 annually (without taking into account EITE free allocations). This would be a significant cost and would have to be managed as part

of the business model. At the higher end of the scale, it is likely to put the growers out of business.

As mentioned previously the ability of growers to convert and the availability of biofuels especially in the South Island means they cannot avoid the increased costs. Whilst it is recognised that the EITE allocation would increase, the overall cost to the grower would still increase. It is worth noting that the EITE allocation for covered cropping is based on yield rather than actual emissions, creating a disparity of benefits among growers, depending on their fuel type.

b) any NZ ETS administrative or operational issues, for example the option for participants to apply for a unique emissions factor.

Feedback in general from growers is that the NZETS is difficult to understand, the administrative efficiency of the EITE allocation programme is lacking, and that the EITE model for covered crops is not effectively targeted at those paying the most for NZ units.

A well-functioning robust international framework which includes access for New Zealand to international units at affordable prices would be required before the government imposes the full surrender option.

5. If full surrender obligations are applied, when should these be implemented?

HortNZ, TNZ and VNZ Inc.'s position is that the introduction of a full surrender obligation option should depend on the international climate for action on the Paris Agreement. As a small market, to take the lead with an independent ETS that is not linked to international carbon trading could prove detrimental to both the domestic and export based market for fruit and vegetables in New Zealand as it may not be competing on a level playing field in an already very competitive international market.

6. If the ETS moves to full surrender obligations, should potential price shocks be managed?

Yes - HortNZ supports the retention of the fixed price for carbon emitted at \$25 and submits that this should be extended until at least 2020, to prevent a surge in costs for business, if the ETS is to move to full surrender obligations. As mentioned in the NZIER report the removal of the fixed price option has no material impact if the market emissions price is below \$25. However, if the full surrender were to happen and prices per unit were to increase to \$50 there would be associated negative effects.⁴ This would presumably occur only if the market was not open at all to the international market and therefore controlled by the government at artificially high rates. This might force some growers to adopt lower energy intensive practices but would more likely put them out of business. It is difficult to comment on one question without considering the global and national policy context of this quite complicated issue.

7. If potential price shocks associated with moving to full surrender obligations should be managed, how should this be done?

⁴ NZIER report page 11.

- a) **maintain the fixed price option**
- b) **lower the fixed price option**
- c) **gradually remove to full surrender obligation**
- d) **other methods**

a) and c) - As discussed above keeping the \$25 as a price cap to ensure prices do not exponentially increase whilst phasing from the one for two surrendering obligation to the development of an internationally recognised carbon trading mechanism would allow exporters and primary producers to compete on a more even playing field.

Thank you for the opportunity to submit to the Ministry for Environment on the New Zealand Emissions Trading Scheme Review 2015/2016.



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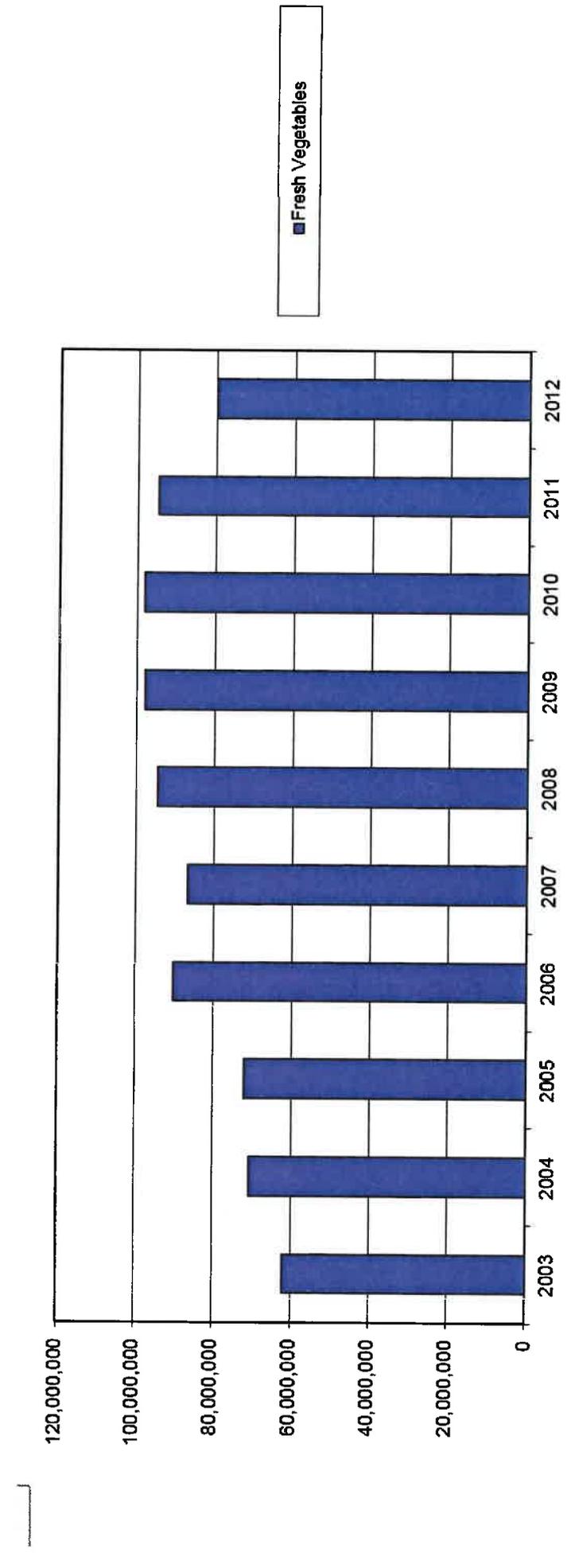


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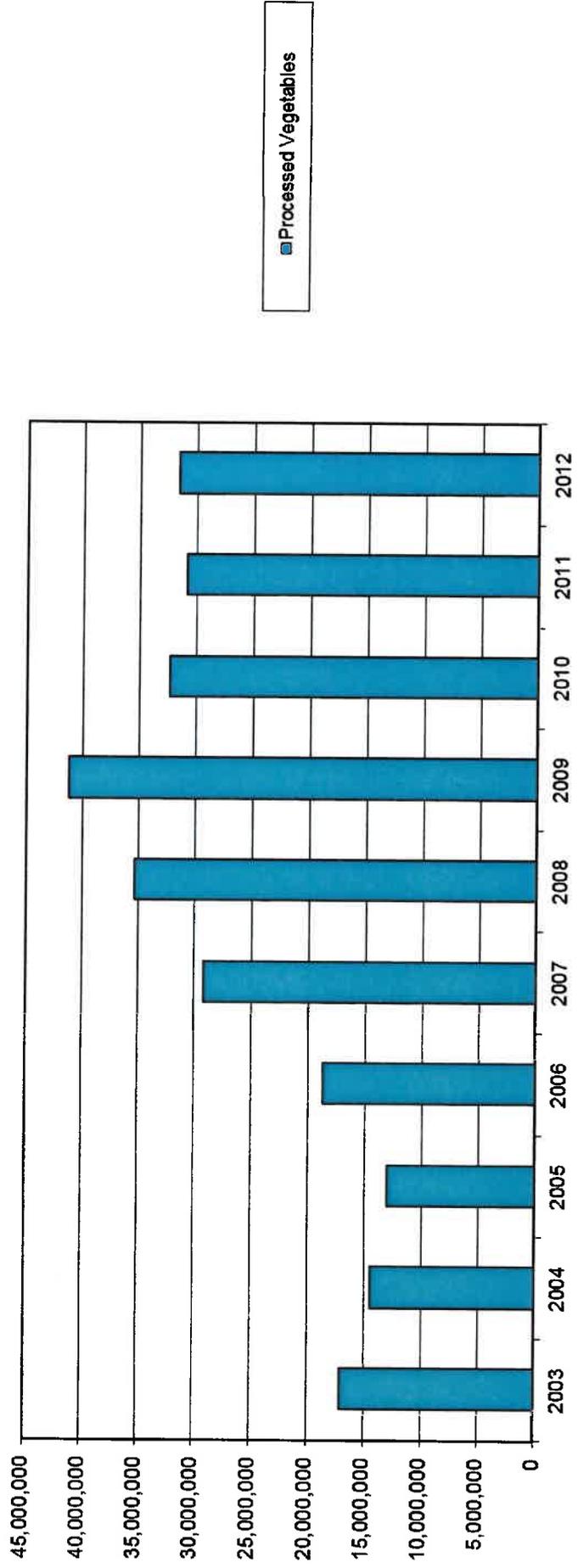
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Fresh Vegetables Import Value NZ\$ 2003 - 2012



Source: Statistics New Zealand

Processed Vegetables Import Sale value NZ\$FOB 2003 - 2012



Source: Statistics New Zealand