WORLD ENERGY COUNCIL | BusinessNZ Energy Council

THE NEED FOR GOVERNMENT ASSISTANCE IN **THE GAS TRANSITION**

Natural gas powers thousands of businesses and as gas supply drops, the impact and risk of government inaction threatens to erode operations that directly generate $18 – 24 billion in GDP for New Zealand.

Economic Scale of Gas Users

Natural gas powers hundreds of large industrial businesses in critical sectors such as petrochemicals, fertilisers, manufacturing, wood processing, dairy processing, meat works and aluminium recycling. Alongside these industrial users are thousands of commercial users, small and large, that are just as reliant including bakeries, coffee roasters, greenhouses, breweries, restaurants, chocolate makers, hospitals, schools and wineries.[1]

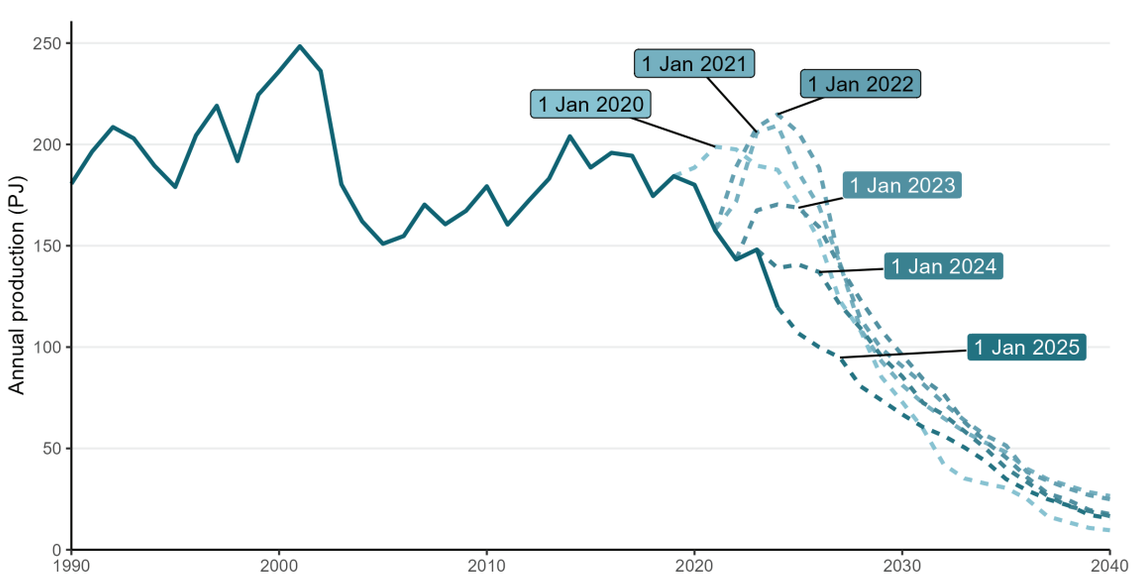
Combined, these operations directly generate $18 – 24 billion in GDP (6 – 8% of total) and support 220,000 – 264,000 direct jobs. Including multiplier effects, this expands to $27 – 36 billion in GDP and 330,000 – 400,000 total jobs, representing 12 – 14% of the workforce.[2]

Recent briefing papers released by MBIE related to the economic impacts of declining gas supply and the associated Sense Partners report show that if natural gas prices continue to climb then by 2035 New Zealand's real GDP will be $4.5 billion lower than baseline. In an LNG scenario real GDP will still be $3.5 billion lower than it would have been. We see this as an urgent reason to pull all available levers to limit the effect of higher natural gas prices on the economy.

Risks of Inaction

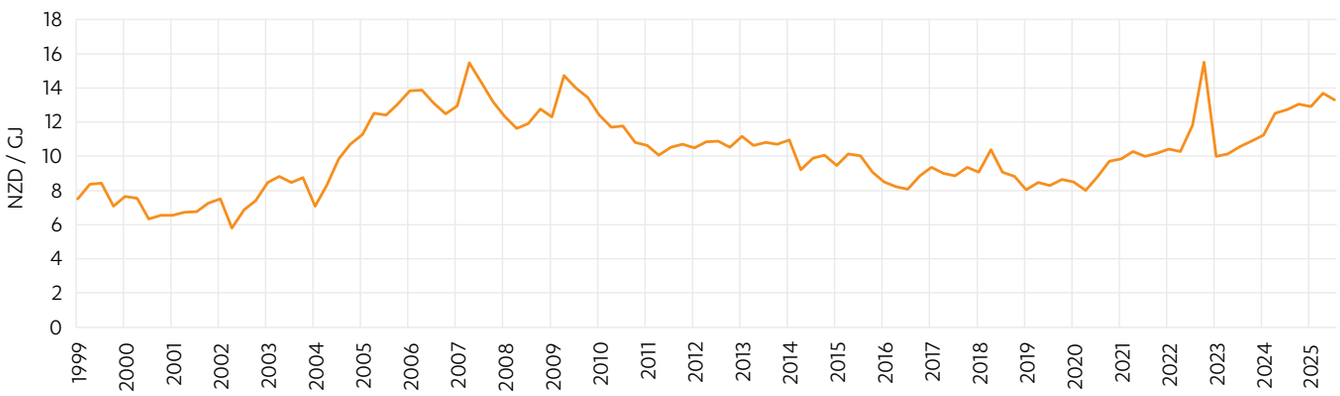
Declining domestic gas supplies, caused by end-of-life oil and gas fields have instilled a supply crunch while sovereign risk (political flip-flops or reversals on new oil and gas exploration) has stifled new investment. This is likely to tighten further, threatening fuel availability, putting upward pressure on prices and risking business closures (see graph 1).

Graph 1 **Gas production profiles for future years (forecasted)**

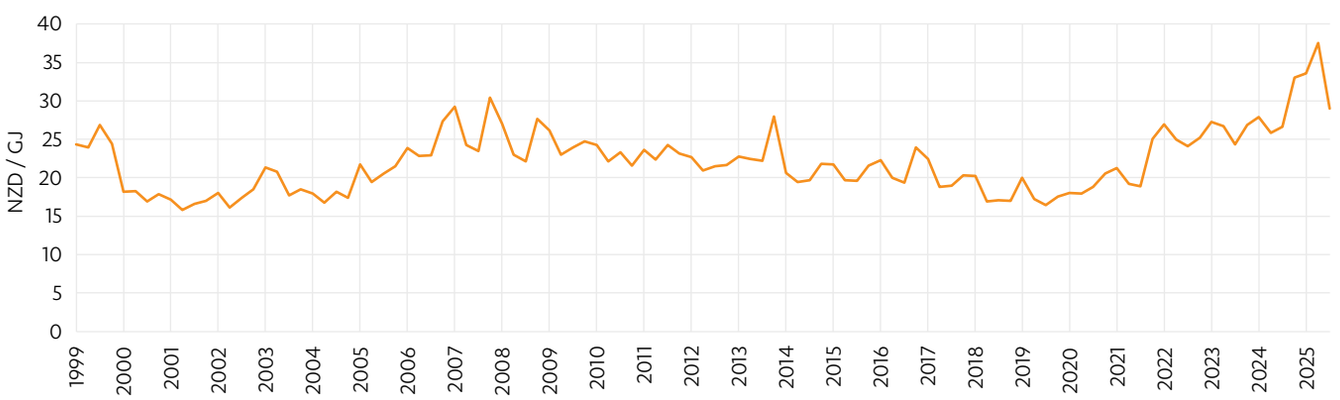


It will lead to the offshoring of manufacturing, with investors moving to nations with lower cost energy and more durable policy settings. While this government has taken positive steps to improve the regulatory environment (Regulatory Standards Act 2025) and through policies to de-risk investment (the building of LNG infrastructure), these are unlikely to help the immediate pressures that businesses are facing. We have seen that, in real terms, the price of natural gas for industrial and commercial businesses is currently sitting at 30% and 32% higher respectively than the 25-year average[3] (see graphs 2 – 3).

Graph 2 **Real Historic Price of Gas for Industrial Users**



Graph 3 **Real Historic Price of Gas for Commercial Users**



In our survey of industrial and commercial gas users, in conjunction with Optima, we found that 40% of businesses have seen more than a doubling in the price of natural gas over the last 5 years.

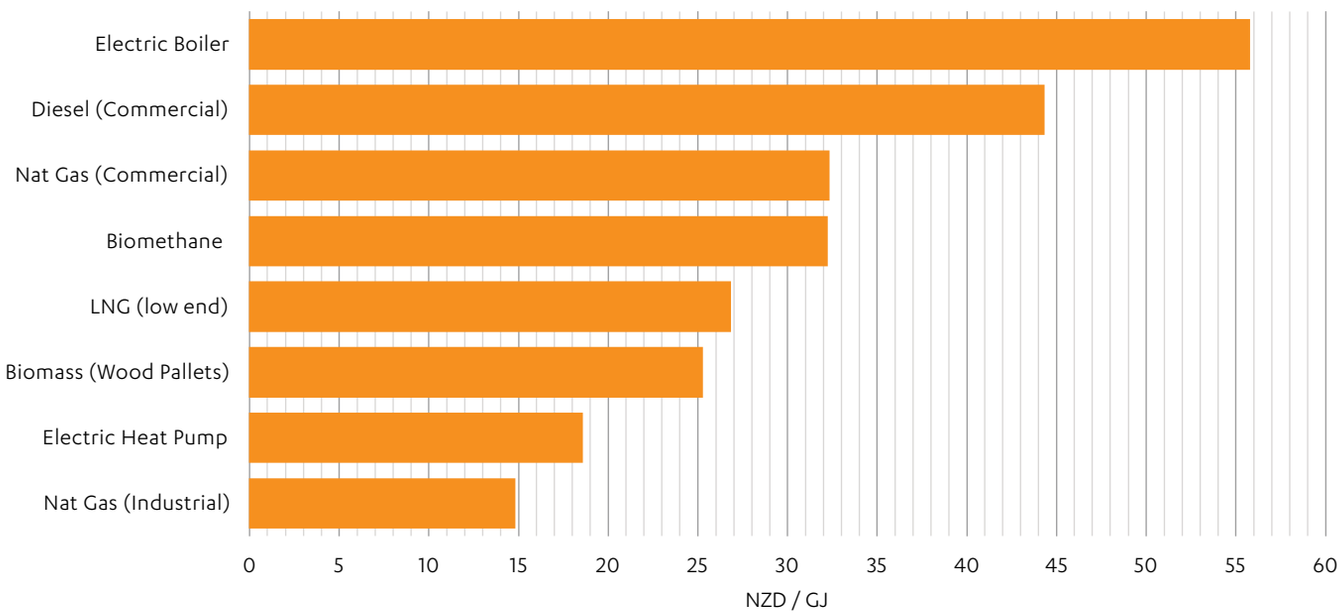
To stay in business, CEOs are being forced to decide whether to make large capital investments to move off gas, often for limited or no impact on business output, soak up higher operating costs, or to stop operating in New Zealand. Businesses considering a switch may find that alternative options offer little or no reduction in input costs compared with natural gas, despite being asked to make substantial capital investments[4, 5, 6] (see graph 4).

While electric heat pumps do have the potential to offer lower operating costs, they are only feasible for businesses with heat requirements under 100 degrees Celsius and may be limited by local network constraints.

EECA has identified the following industries as suitable for heat pumps

- Dairy, meat, food and beverage product manufacturing
- Wood product manufacturing
- Textile, leather, clothing and footwear manufacturing
- Indoor cropping
- Agriculture

Graph 4 **Operating Cost Comparison of Fuel Types**



For some firms this may be manageable but for others this capital investment is likely to be much more challenging. Without assistance these businesses face a decision between increasingly uncompetitive energy prices, large capital investment for no tangible gain, reducing output or closure. EECAs work 'SME gas users: how are SMEs responding to gas market uncertainty' indicates that for most businesses transitioning away from gas is theoretically possible, but financially unattractive with costs to upgrade and pay back periods being key barriers to transitioning.[7] If these barriers can be removed or lessened then fuel switching decisions will increasingly be driven by operational logic rather than capital constraint, enabling a smoother and less disruptive transition for businesses.

There are businesses that, due to operational constraints, need to continue with natural gas. The Pinstriped Leopard report 'what's fair?' showed that many businesses still need gas as other options are unable to produce sufficient control, heat or steam for the work they do.[8] Targeted assistance to those that are able to transition will help to free up supply for those who need it most.

Policy Precedents

International peers such as Australia,[9] the UK,[10] the EU,[11, 12] Canada[13, 14] and Japan[15] already mitigate these risks through the use of grants, low/no interest loans and/or subsidies, positioning their industries to remain competitive and ensuring their survival.

The last Labour government recognised that there were cost barriers to transition away from gas, because it was the cheapest fuel option for many businesses. The GIDI fund, despite its flaws, demonstrated that with assistance businesses are able to successfully transition their energy usage away from fossil fuels.

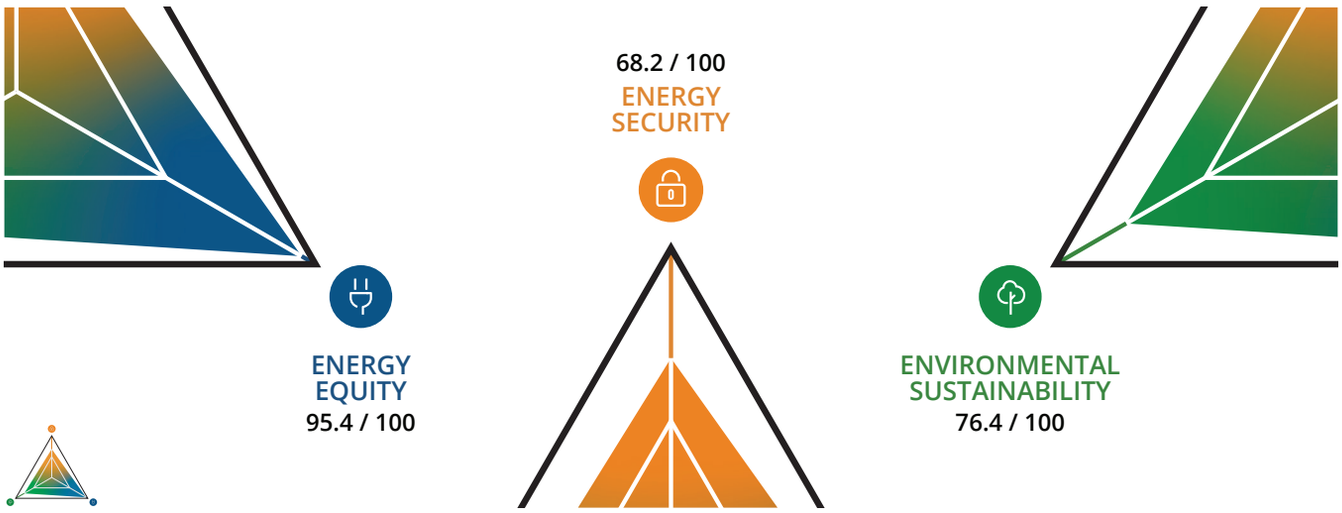
Additionally, this government has previously put $200 million on the table to help in de-risking gas exploration which has since been expanded to support a broader portfolio of projects aimed at accelerating gas supply across short, medium, and long-term horizons.

If the government is willing to provide this assistance to one side of the table, we would like to see them consider similar assistance to the demand side.

Any money the Government has provided to support the supply side (if it is taken up, which is by no means certain) will be wasted if there are no customers left on the demand side. Big energy customers will be required in New Zealand to help de-risk and accelerate investment in new renewable energy options.

Implementing conditional low/no interest loans specifically targeted at businesses most at risk could further accelerate transition and put downward pressure on prices for those who continue to need natural gas.

There are growing calls for demand side assistance to get through this transition, avoid business closures and job losses. The Boston Consulting Group in their work 'Energy to Grow, Securing New Zealand's Future' discussed the need to establish an Industry Resilience Fund to support users transitioning. The Energy Transition Framework's Gas working group included, as one of their recommended actions, the need to develop a government-led demand-side investment mechanism, to provide a structured pathway for businesses to transition.



Policy Risks and Mitigation

Phrases like 'corporate welfare' are bound to be thrown around, but it is our contention that these are not normal times, and the loss of natural gas is not a market failure, but a political miscalculation in the transition to net-zero emissions. There was a belief that net-zero would be costless, affordable and a 'win-win' for the economy and the environment. This combined with the reality that over several years gas reserves and production have consistently been revised down, and actual output sits towards the lower end of previous gas supply scenarios, has contributed to today's supply crunch. The reality we now find ourselves in is that the transition will impose higher energy costs, both capital costs and potentially operating costs, and other countries, that are decarbonising, are providing assistance to businesses to manage these transitional costs.

To minimise risk, any assistance should focus on the initial capital cost of transitioning into a new fuel type and not offsetting increases in cost over a longer period of time. Such a policy should be designed to be a one-off conditional capex loan (or something to a similar effect). When it comes to the design of the support package, there are numerous examples of what other countries have done to choose from.

This policy should not subsidise the ongoing costs of alternative fuels. For businesses where gas remains the best option, either in terms of price or functionality, they should not be incentivised to switch to an alternative what would otherwise be a less effective or more costly choice. It should be designed to only prompt switching when, in terms of opex, alternative fuels would be better, but capital constraints prevent switching. This would ensure that only businesses that would switch, but can't due to lack of capital, are targets. It also ensures that Natural Gas is not artificially made a worse option, over and above the price signal sent by the ETS.

With any policy decision there are trade-offs to be made. The common ones discussed within the energy sector is how to balance the 'energy trilemma', that being the three pillars of security, sustainability and equity. The intent of targeted assistance is not to remove these trade-offs but to manage them, preserving gas for those who need it, thus preserving security, and ensuring that transition costs are shared more fairly between firms and government, thus improving equity.

Call to Action

BusinessNZ does not generally advocate for government intervention of this nature. However, the present situation is a result of previous policy decisions that have distorted market signals and driven businesses towards higher cost fuels. In this context, we believe that intervention can be appropriate. As such we believe that government intervention is needed to protect critical portions of $18 – 24 billion in GDP, and 220,000 – 264,000 jobs while avoiding economic contraction from transition costs that have never been properly factored in. With modelling released by MBIE showing declines in real GDP growth thanks to higher gas prices, we believe it is critical that all available levers are pulled to minimise economic disruption.

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