

The Treasury

2014 Briefings to Incoming Ministers Information Release

Release Document

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Treasury Report: Climate Change - Important Decisions Between Late-2014 and Mid-2015

Date:	Monday 6 October 2014	Report No:	T2014/1674
		File Number:	SH-10-8

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	<p>Note that Ministers will have to make decisions on New Zealand's post-2020 international climate change target and future ETS settings, over the next few months.</p> <p>Note that the cost of meeting climate change targets is expected to rise significantly after 2020.</p> <p>[3, 5]</p> <p>Indicate if you want to meet with the Minister of Climate Change Issues to discuss options for New Zealand's post-2020 target</p>	21 October 2014
Associate Minister of Finance (Hon Steven Joyce)	<p>Note that Ministers will have to make decisions on New Zealand's post-2020 international climate change target and future ETS settings, over the next few months.</p> <p>Note that the cost of meeting climate change targets is expected to rise significantly after 2020.</p> <p>[3, 5]</p> <p>Indicate if you want to meet with the Minister of Climate Change Issues to discuss options for New Zealand's post-2020 target</p>	21 October 2014

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
[4]	Analyst	[4]	[1] ✓
Melody Guy	Manager, Natural Resources	04 917 6059 (wk)	

Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Forward a copy of this report to the Minister for Climate Change Issues

Enclosure: No

Treasury Report: Climate Change - Important Decisions Between Late-2014 and Mid-2015

Executive Summary

Ministers will need to make important decisions about international and domestic climate change policy settings between late-2014 and mid-2015. First and most importantly, Ministers will need to consider options for New Zealand's post-2020 emissions reduction target and what (if any) public consultation to do on the options. Second, Ministers will need to consider changes to Emissions Trading Scheme (ETS) settings [3]

[3, 5]

The Government has committed to working with other countries to put a new international agreement in place by the end of 2015. As part of this, New Zealand will be expected to table a post-2020 emissions reduction target in the middle of 2015. Ministers will need to balance a range of competing objectives in shaping the target, [3, 5]

The Minister for Climate Change Issues may bring a paper to Cabinet in November with potential target options.

In Treasury's view, New Zealand's objective should be to take a target that imposes a roughly equal cost to other countries as a percentage of GDP, and therefore represents our "fair share" of global mitigation effort. This is particularly important because the costs of meeting targets after 2020 are expected to rise significantly as our emissions are forecast to increase and carbon prices are likely to be higher. For example, continuing New Zealand's current target to reduce emissions to 5% below 1990 levels over 2021-2030 could have an economic cost to New Zealand of between [3, 5]

²

Taking a fair share target is particularly important for New Zealand. Our emissions profile is close to that of a developing country, with around half of our emissions coming from the agriculture sector. [3, 5]

Stringent emissions targets would also increase energy and fuel costs for households and firms, who often have few options to switch to less carbon intensive products. This would have particular impacts on low-income households

¹ [3, 5]

² Costs are provisional and subject to a number of assumptions [5]
They are also subject to change following further modelling.

Ministers have more options than they have had before in negotiations to shape a target that reflects our “fair share”, [3, 5]

We recommend that you consult with the Minister for Climate Change Issues soon to ensure that any paper he brings to Cabinet before Christmas adequately addresses this trade-off. This is also an opportunity to discuss whether and how to consult the public on options for New Zealand’s post-2020 contribution.

Deciding New Zealand’s *post-2020* target does not have immediate implications for domestic policy. However, Ministers will need to consider changes to ETS settings in 2015 that will apply *pre-2020*. These decisions are an opportunity to provide more certainty about the ongoing operation and settings of the ETS. This will assist firms and individuals to better factor climate change into their long-term decision-making. The two sets of decisions, will jointly set New Zealand’s long-term climate change policy for the time being

Recommended Action

We recommend that you:

- a **Note** that Ministers will need to make important decisions about international and domestic climate change policy settings between late 2014 and mid-2015
- b **Note** that the most important decision is about options for New Zealand’s post-2020 emissions reduction target. The Minister for Climate Change Issues may bring a paper to Cabinet in November 2014 on potential options and what public consultation to do
- c **Note** that the cost of meeting climate change targets after 2020 is expected to rise
- d **Note** the Treasury’s view that these costs should be managed by taking a target that is roughly equal in cost to the targets of other developed countries, which would reflect our “fair share” of global mitigation effort

[3, 5]

[3, 5]

- g **Note** that we recommend early discussion with your Ministerial colleagues to help focus policy development on options that manage cost while also addressing credibility risks, and also to discuss how (if at all) to consult the public on the options
- h **Indicate** if you wish to meet with the Minister of Climate Change Issues to discuss options for New Zealand’s post-2020 emissions target

Yes/no

Minister of Finance

Yes/no

Associate Minister of Finance

- i **Note** that Cabinet has agreed to review the ETS in 2015 and to consider introducing a mechanism to auction units into the ETS. This is an opportunity to provide greater certainty about the ongoing operation and settings of the ETS.

j **Indicate** if you wish to discuss this briefing, and

Yes/no

Minister of Finance

Yes/no

Associate Minister of Finance

k **Refer** to the Minister for Climate Change Issues.

Refer/not referred

Minister of Finance

Refer/not referred

Associate Minister of Finance

Melody Guy

Manager, Natural Resources

Hon Bill English

Minister of Finance

Hon Steven Joyce

Associate Minister of Finance

Treasury Report: Climate Change - Important Decisions Between Late-2014 and Mid-2015

Purpose of Report

1. This report updates you on important climate change decisions that Ministers will need to make between late-2014 and mid-2015. It recommends early discussion with your Ministerial colleagues to focus policy development on options to manage long-term fiscal and economic risks.

Analysis

2. Ministers will need to make important decisions about international and domestic climate change policy settings between late-2014 and mid-2015. Annex A contains an indicative timeline of these decisions.

International climate change policy: post-2020 emissions reduction target

3. First and most importantly, Ministers will need to consider options for New Zealand's post-2020 emissions reduction target and what (if any) public consultation is needed.

The international negotiations – a “bottom-up” approach presents opportunity

4. The Government has committed to working with international partners to put a new international agreement in place by the end of 2015. As part of this, New Zealand will be expected to table a post-2020 emissions reduction target before the December 2015 negotiation conference.
5. There are good reasons for New Zealand to participate in a new global agreement. Our participation lets us to retain some influence over aspects of the negotiations which are particularly important to us and may help encourage wider global action. Participating may also enhance our reputation as a good international citizen and supporter of rules-based international processes.
6. These negotiations are also an opportunity to secure better international climate change obligations than we have had to date. They represent a break from the traditional Kyoto Protocol-type framework with top-down, inflexible rules that don't adequately reflect differences between countries. Instead, the agreement will be built from the “bottom-up” with countries determining for themselves the form and level of their targets and the rules they intend to apply when measuring and reporting progress towards meeting them. For example, some developing countries may specify targets that allow emissions growth before peaking and reducing.³
7. The purpose of this “bottom-up” flexibility is to encourage as many countries as possible to participate in the agreement. This may mean that the level of action is less than is required to limit global warming to two degrees, but negotiators have chosen to prioritise participation at this point in time. Further negotiations may seek to increase the level of action that countries undertake. New Zealand has proposed a “one-way ratchet” under the new agreement requiring countries to increase the stringency of their targets over time.

³ China recently said its aim was to reduce emissions of carbon per unit of GDP by 45% by 2020 and for its emissions to peak as early as possible.

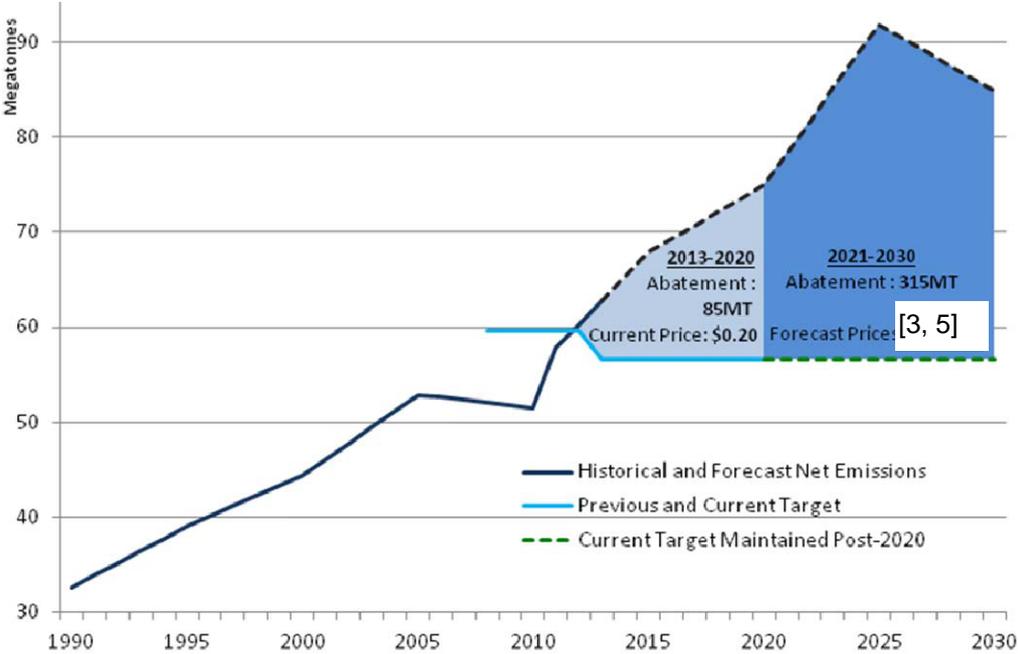
New Zealand's objective in the negotiations: take a target reflecting our "fair share"

8. Ministers will need to balance competing objectives when shaping New Zealand's target. New Zealand's objective should be to take a target that reflects our "fair share" of global mitigation effort. Different approaches can be applied to assess fair targets between countries, but in our view the starting point should be an "equal cost" approach. This approach is based on the premise that fair targets should impose approximately equal costs as a percentage of GDP in each country. This means that countries may achieve different amounts of emission reductions, but will share the burden of reducing emissions equally.
9. Taking an equal cost target allows New Zealand to participate in the global transition to a low carbon economy, in step with other countries, while avoiding excessively high economic costs. It permits gradual and consistent structural economic changes over the medium-to-long term, ideally towards a globally agreed level of global emissions.
10. On the other hand, taking a target that requires New Zealand to do more than its fair share will impose excessive costs, and not meet the environmental objective since New Zealand is only a small contributor of global GHG emissions. There could also be significant trade impacts from taking stronger action than our competitors. [3, 5]
11. Without additional measures to compensate, the increased costs are likely to fall disproportionately on lower socio-economic groups who spend a greater share of their income on carbon intensive products like electricity and petrol.

The costs of meeting targets is expected to increase significantly after 2020

12. Taking a "fair share" target is particularly important because the costs of meeting targets after 2020 could rise significantly. New Zealand's emissions are forecast to increase and carbon prices are likely to be higher than they are today. It is generally more expensive for New Zealand to reduce emissions than it is for other developed countries because of our emissions profile and national circumstances. In particular, we have a growing population, an already high proportion of renewable energy, and half of our emissions are from agriculture. Stringent targets after 2020 that do not account for these national circumstances could become very expensive.
13. For example, continuing New Zealand's current target to reduce emissions to 5% below 1990 levels over 2021-2030 could cost between [3, 5]
14. Figure one shows why the cost of meeting targets after 2020 is likely to be higher than the costs from targets so far. The amount of abatement needed from 2021-2030 would be around 315 megatonnes (MT), even if the post-2020 target is no more ambitious than the current target, compared to 85MT of abatement needed over the current commitment period. Carbon prices are also predicted to be significantly higher after 2020, at between [3, 5] compared to the current international price of less than \$1.

Figure One: New Zealand’s Net Greenhouse Gas Emissions and Current Targets to 2030



Options to manage cost exist, [3, 5]

The “bottom-up” negotiations give Ministers more options than they have had in the past to shape a target that reflects New Zealand’s national circumstances. [3, 5]

[3, 5]

[3, 5]

Public consultation

23. There is no legal obligation to consult the public on New Zealand's post-2020 emissions target. Ministers have consulted in similar circumstances in the past, however, and so domestic stakeholders are likely to expect consultation.
24. In our view, there is value in a open consultation process. These negotiations present different issues from previous negotiations and give New Zealand different options. It would be useful to consult the public and key stakeholder groups about these issues and options before deciding on a final target form.

Discuss options with your Ministerial colleagues

25. The Minister for Climate Change Issues is considering options for targets [3]. He may bring a paper to Cabinet in November 2014. It would be advantageous to have an early discussion with the Minister for Climate Change Issues and other senior Ministers about the issues covered in this report. [3, 5]

It would also be an opportunity to discuss what kind of public consultation may be desirable.

The link to domestic policy: opportunity to provide longer-term regulatory certainty

26. Tabling a post-2020 target [3, 5] does not have immediate implications for domestic policy settings, but changes may be needed before 2020 to ensure the scheme will allow New Zealand to meet the new target. [3]
Ministers will need to consider the terms of reference for a review the ETS [CAB Min (12) 23/10] and to consider introducing a mechanism to auction units into the ETS [EGI Min (14) 16/7].
27. The ETS has been amended several times in recent years; the last time in Budget legislation without public warning. The ETS was also the subject of political party manifestos at the election, with some parties suggesting repeal altogether. There is, therefore, a degree of regulatory uncertainty surrounding the continued operation of the ETS and its precise settings.
28. While there is evidence that some firms are factoring future carbon prices into their long-term decisions in spite of this uncertainty, individual firms and business groups have said that greater certainty about long-term policy settings would help firms make better decisions and increase the level of abatement activity.
29. Taken together, the decision about New Zealand's post-2020 target and any changes to ETS settings in the pre-2020 period will set New Zealand's long-term climate change policy settings. In our view, these decisions are an opportunity to provide greater certainty about the ongoing operation and settings of the ETS. This will assist firms and individuals to better factor climate change into their long-term decision-making.
30. If Ministers are interested in taking explicit steps to provide greater regulatory certainty, the decisions needed before [3] are an opportunity to do so. The first would be to consult on the design of an auctioning process [3, 5]
Secondly, when taking a post-2020 target, signal the longer-term changes to ETS settings that will be required to meet the target.
31. Beyond those two steps there are a number of things Ministers could consider to provide greater certainty. Probably the most significant would be to secure a greater degree of political party consensus about targets and ETS settings. Another approach would be to institutionalise regular reporting on long-term targets and regulatory settings. The latter approach has been used with some success overseas. Officials can provide more advice about possible steps if you are interested`.

[Not relevant]

Annex A: Timeline of Climate Change Decisions - 2014 and 2015

[3, 5]