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To: Office of Minister of Finance

AIDE MEMOIRE: FURTHER ANALYSIS ON 2020 TARGETS

This note responds to questions raised during a telephone conversation between Hon Bill English and Andrew Blazey on Tuesday 27 July.

Announcing a unilateral target

Treasury recommends you propose a target range of 8%, 15% and 26% below 2005.

The 8% target would be unilateral target (unconditional, but based on the targets currently announced by other countries), and the 15 and 26% target would be conditional on more ambitious targets from developed and developing countries.

[information deleted in order to avoid prejudice to the security or defence of New Zealand or the international relations of the Government of New Zealand; and to maintain the effective conduct of public affairs through the free and frank expression of opinions; and to enable the Crown to carry on negotiations without prejudice or disadvantage]

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Treasury recommends New Zealand announce a target range which includes a unilateral target based on the current targets announced by developed countries, and more ambitious targets based on specific developed and developing countries' targets.

Inclusion of the forestry sector

Treasury's proposed target range does not include the carbon emitted or absorbed by the forestry sector. This is because:

- the international accounting rules for forestry have not been finalised
- there is insufficient economic analysis to accurately project emissions
- *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*
- including forestry may result in a more ambitious target being announced without consideration of the liabilities New Zealand will face when the forests are harvested.

There is considerable uncertainty in the possible accounting rules for this sector and major risks from assuming a particular set of rules at this time. *[information deleted in order to enable the Crown to carry on negotiations without prejudice or disadvantage]*

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Other rules are also proposed by some countries, for example a move from gross-net to net-net accounting. If this rule was agreed internationally, New Zealand would need to renegotiate its targets, as under net-net accounting the number of units New Zealand receives from the UN would reduce by about 30%.

Forecasting the amount of carbon emitted or absorbed by the forestry sector is highly uncertain. For example, MAF notes that emissions from the forestry sector are affected by the harvest age, and projects that forests could either be emitting about 20MT (harvest age 26 years) or absorbing approximately 13MT (harvest age 40 years) in 2020. Including a price of carbon adds to this uncertainty. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]* Basing a target on speculative forecasts and rough economic analysis is risky.

Finally, if ministers were to assume more forests are planted or foresters delay their harvesting as a basis for announcing an ambitious 2020 target, for every tonne of carbon absorbed by forestry there is an associated future liability. In the long term the forestry sector is essentially a zero sum game, notwithstanding some limited opportunities to reduce emissions by never cutting forests down or by permanently changing land use into forestry and benefiting from the carbon stored in roots and stumps.

Treasury recommends that given the uncertainty in the future accounting rules, the lack of peer-reviewed analysis on emissions projections, and the risks associated with only considering the short-term benefits of forestry, the 2020 target announcement should be exclusive of the forestry sector.

Climate change decisions

Climate change initiatives are not in a single package, but span a range of proposals:

- Emissions trading scheme
- 2020 emissions target
- Commitments for the second commitment period of the Kyoto Protocol (CP2)
- Financing arrangements for developing countries *[confidentiality of advice]*
- Ad hoc proposals to promote mitigation and adaption, *[information deleted in order to avoid prejudice to the security or defence of New Zealand or the international relations of the Government of New Zealand; and to enable the Crown to carry on negotiations without prejudice or disadvantage]*

A 2020 target needs to be credible, yet achievable. In the context of the number of decisions with economic and fiscal implications, Treasury is focused on the affordability of the decisions relative to the costs incurred by other countries.

[free and frank], Analyst, Economic Performance Group, *[privacy]*.

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