REDD: New Zealand’s Views on Policy Approaches and Positive Incentives

Accra, Ghana

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New Zealand Government

sustainability

Process so far

- Bali Action Plan initiated consideration of possible policy approaches and positive incentives for REDD+
- SBSTA's work demonstrated that robust methodologies are available or can be developed for REDD
- New Zealand considers there is no technical or methodological impediment to now developing a mechanism to provide economic incentives for REDD
- Final methodologies can be developed once a policy approach has been elaborated further
- Time is short. Not only because of magnitude of emissions, but because of possible links to AWG-KP and AWG-LCA processes.

Discussions to date

- One key issue is how a financial incentive might be provided. Two main approaches have been raised:
  – **A fund** paid to developing countries that meet performance objectives; or
  – Using a Kyoto Protocol-type **market mechanism** to allow reduced emissions to create tradable 'emission units'.
- Both approaches have positives and negatives.
- Either could work provided key challenges are addressed.
- Either approach is likely to require other funding for building capacity, technology transfer, assisting governance and enforcement, related economic development programmes (e.g. forestry and agricultural projects), demonstration projects, etc.

High-level Economics of Deforestation

- Economic analysis shows that for many developing countries the opportunity cost of retaining their current area of forest (and therefore foregoing development opportunities) is higher than the marginal benefit they receive from retaining that area of forest.
- Many governments are therefore responding in an economically rational way given the costs and benefits before them.
- Without an incentive mechanism, forest area will continue to decline until a country reaches a socially optimal forest area cover; where its national-level marginal cost of retention is equal to its national-level marginal benefit of retention.
- Most developed and some developing countries have already gone through this process. Many now have some form of regulation to limit further deforestation.
- Critically, when the global values of forest retention are added, especially the value to the climate system, the socially optimal area of forest retention increases significantly.
- Monetising these external global benefits of forest retention to the climate system should be the focus of our REDD discussions.

Why are these underlying economics of deforestation important for negotiations?

- Proposals focusing solely on capacity building, governance, etc are unlikely to work.
- A project-based mechanism is unlikely to succeed, as it would only increase the benefits of forest retention in the area subject to the project.
- The REDD mechanism must provide compensation to a country in return for that country retaining forest cover at a level higher than optimal for them.
- If funding stops, deforestation will probably return to pre-REDD mechanism levels.
- Any country that has forest area above its <u>national-level</u> socially optimal coverage will require compensation to reduce deforestation - regardless of its recent deforestation rates.
- Any country already at its socially optimal forest cover will not require compensation to retain that level of forest cover.
- The exception is where the opportunity costs of forest retention rise in future; something that could happen with rising food prices. If so, some financial incentive may be required for countries to maintain forest cover.
- As countries develop they generally receive greater benefits from retained forests. It may be that over time the need for incentives will diminish.

In general New Zealand considers that:

- A market-based approach is likely to be more durable and economically efficient than a fund-based approach, but both approaches have benefits and drawbacks.
- A market-based approach comes with significant risks of either:
  - flooding the carbon market and therefore reducing focus on fossil fuel abatement; or
  - 'avoided deforestation credits' not materialising and countries being forced into far more costly abatement options.
- Some matching of supply and demand could help - but this is likely to be very difficult in the absence of any market evidence.
- There should be no presumption that the source of financial resources to address REDD is limited to Annex 1 countries only.
- A national-based mechanism (be it market or funds based) is likely to be significantly superior to a project-based mechanism.
- Some form of project-based mechanism may be appropriate as an initial step to aid countries' development of a national-level approach.
- A REDD mechanism should have maximum potential for global coverage to address inter-country leakage.
- An international financially based mechanism does not mean that domestic policies need to be economic instruments. Domestic policies are up to sovereign governments applicable in their circumstances.