



Submission by

NZ Forest Owners Association

- to the -

The Emissions Trading Scheme
Review Committee

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1. Introduction

- 1.1 The NZ Forest Owners Association (NZFOA) welcomes the opportunity to comment on the review of the Emissions Trading Scheme. Forestry is the only sector that is currently included and bound by regulations under the emissions trading legislation. It has been since the beginning of 2008.
- 1.2 By the time any potential amendments are introduced forest investors will, by law, have been required to commit to a number of decisions. Clearly, any review of the scheme should take this into account.
- 1.3 Increased planting and a growing forest sector will be required if New Zealand is to avoid having an even greater emissions hurdle to overcome. Restoration of investment requires the treatment of pre-1990 forest owners to be addressed.
- 1.4 The NZFOA is an NGO that represents the majority of forest owners in New Zealand. Its members' forests comprise around 80 per cent of the country's 1.8 million hectares of plantation forestry. The NZFOA has also caucused widely with other forestry groups and the views represented here are widely supported.
- 1.5 The outcome of this review will determine whether forestry is allowed to achieve its potential of providing New Zealand with an effective, and efficient, means of meeting its carbon emissions commitments.

2. Relevance to Terms of Reference

- 2.1 With respect to the terms of reference for the Review Committee our proposals are pertinent to the following:
 - the prospects for an international agreement on climate change post-Kyoto 1, and the form such an agreement might take;
 - the impact on the NZ economy and NZ households of any climate change policies, having regard to the weak state of the economy, the need to safeguard NZ's international competitiveness, the position of trade-exposed industries, and the actions of competing countries;
 - the relative merits of an ETS or a tax on carbon or energy as a NZ response to climate change;
 - and particularly the need for any additional regulatory interventions to combat climate change if a price mechanism (an ETS or a tax) is introduced.

3. Summary

- 3.1 The NZFOA submitted one year ago on the development of the Emissions Trading Scheme. Our position on key aspects remains unchanged and continues to have the support of a wide range of forestry groups.
- 3.2 The NZFOA considers that the majority of the ETS should be preserved given the development to date and the need for investment certainty. Wholesale changes, including to the timetable for entry by sectors, are not warranted.
- 3.3 The forest sector requires policy certainty if investment is to be successfully attracted into the sector. It also requires equitable treatment with other land using sectors within NZ if it is to compete successfully.
- 3.4 For forestry to respond positively to the ETS signals it is important that emitters face a price signal that drives behavioural change. Without this there will be no functioning carbon market and New Zealand's carbon emissions profile will remain a problem for future generations. While full exposure of NZ's "trade-exposed" exporting industries (including pulp, paper and wood panels) to international obligations would be too damaging, there is action that all emitters, including agriculture, can take and should be encouraged to take now.
- 3.5 The ETS has a number of potentially beneficial aspects that encourage forestry. The key remaining concern for forest growers is the treatment of forests established before 1990 which is quite different to the treatment of other forests.
- 3.6 The government has the option of removing pre-1990 forestry from the ETS and with it the artificial distinction between pre and post-1990 forests. Exclusion of pre-1990 forests is proposed under the Australian scheme and this should be reconsidered by the government here. The short-term cost of deforestation needs to be set against the long-term benefit of best use of our productive lands.
- 3.7 If pre-1990 forestry is to remain within the ETS the level of compensation provided for loss of capital value through loss of land use flexibility should be improved beyond the current low level of 5% (or 4% after exemptions). The ETS Bill acknowledged that all forest land has been devalued as a result of having a permanent liability attached to it. For those with the option of a higher and better use for the land, however, the compensation is of an order of magnitude less than the liability imposed. Furthermore, this compensation is eroded by the cost of exempting owners of small forests from any penalties.

- 3.8 The ability to replant forests in a better location without penalty when there is no change in the impact on the atmosphere seems absurdly obvious. ETS provisions to permit forest-offsetting could be added to the existing compensation units to provide a more realistic overall compensation package, recognising there will still be a significant net cost with relocating forests arising from redeveloping land and infrastructure. Furthermore the permanent restriction on the land will not have been removed.
- 3.9 The forest policy approach to pre-1990 forestry to date has been focused on adhering to the letter of the Kyoto Protocol wording and on minimizing the costs to Crown during the five years of the first commitment period. This is exemplified by the replanting restrictions on pre-1990 forestry which Kyoto does not require. The policy should focus on maximising the long-term benefits from New Zealand's primary sector.
- 3.10 To encourage greater investment in new forest planting two amendments to the regulations pertaining to forest developed post-2008 can relatively easily be implemented.
- 3.11 The option of choosing to receive credits equal to the long-term average level of the forest should be provided for in the regulations. In return for foregoing the credits above the average these forest owners would not incur a liability at harvest so long as they replanted.
- 3.12 The regulations should include coverage of carbon loss related to major catastrophic forest failure beyond the reasonable ability of forest owners to manage such as biological incursions arising from breaches of border biosecurity, Cyclone Bola type blow-down events or wildfire (be it lightning triggered, arson or accidental ignition at the urban interface) as the Australian government ETS equivalent is proposing.

4. The Option of a Carbon Tax

- 4.1 Unlike most other parties the NZFOA's preference was always for a carbon tax. The Association's response when a carbon tax was first mooted was one of support so long as revenue recycling was included. It was supported because of the greater transparency, efficiency and equity. This position was reiterated last year.
- 4.2 However, since that time the machinery for an emissions trading scheme has been developed and put in place. Legislation has been passed, investment decisions in forestry have been made on the basis of an ETS, and other significant parties internationally have signalled a commitment to the same track, notably the USA and Australia.
- 4.3 A number of submitters who originally opposed a carbon tax are now in favour of considering it as an alternative to the ETS. In our view the time for that option has passed and embarking now on the development of an alternative to the ETS will result in a further significant delay in New Zealand addressing its emissions. Nor will a carbon tax be guaranteed any broad level of support at the end of the process when submissions are once again called for.

5. Pre-1990 Forestry

- 5.1 New Zealand is the only country in the world that is proposing a carbon tax on deforestation and restrictions on replanting of pre-1990 forests.
- 5.2 The industry remains opposed to the inclusion of pre-1990 forestry in the ETS without adequate compensation. The ETS is reinforcing permanent artificial divisions between forests that are delivering the same products into the same markets. This has caused considerable damage to the confidence to invest in forestry in New Zealand. In terms of regulatory intervention government should:
 - either remove pre-1990 forestry from the ETS
 - or provide adequate compensation.

6. Removal of Pre-1990 Forestry from the ETS

- 6.1 The Forest Owners Association's long-held position is that pre-1990 forestry should not face penalties under the ETS. It impinges on property rights and has badly damaged investment confidence.

- 6.2 The Australian government is proposing to exclude pre-1990 forestry from its equivalent of the ETS and New Zealand also has the option to do this as was originally proposed under the National Party's "Blue-Green" policy manifesto.
- 6.3 Under the current Kyoto obligations there is a cost associated with allowing deforestation. This is a cost that the government should bear as part of ratifying the Kyoto Protocol just as the government is liable for the cost of all agricultural emissions. It is acknowledged that Australia's negotiation of Article 3.7 in the Kyoto Protocol does reduce this burden for that country for the first commitment period. Article 3.7 allows countries who had a high level of land use change in 1990 (namely Australia) to use this as their baseline level of land use change. Nonetheless Australia's rate of deforestation is not negligible - it makes up 11% of total emissions – and yet deforestation will not be included.

7. Adequate Compensation for Pre-1990 Forestry

- 7.1 All pre-1990 forest owners have had their land devalued regardless of its potential for alternate use. The price paid for land with a permanent encumbrance on it will obviously be less than without that encumbrance. The Emissions Trading Bill observed that *"all pre-1990 forest land value is likely to be affected to some degree"*. Indeed, it was acknowledged that there is justification in a number of the criticisms that are made relating to pre-1990 forestry.
- 7.2 In a number of areas forestry is the "highest and best use" for land and an alternative is not currently considered practical. However, it cannot be stated with any confidence that this will always be the case. Land previously thought unsuitable for pastoral agriculture has proven to be much more productive in dairying, wine-growing etc. Similarly, lifestyle or residential conversion is always a possibility depending on other development patterns and the potential for forest-based biofuel crops remains undeveloped in NZ.
- 7.3 The previous government, through its public discussion document on the ETS, acknowledged that the opportunity to profitably introduce new land uses will be reduced by the deforestation tax, and concluded that most forest owners will face economic loss as a consequence.

- 7.4 An allocation of 39 units, or in a smaller number of cases, 60 units, has been made in recognition that land values have been affected. Even this compensation has been reduced. Of the 55 million units nominally available to 2020, 9.4 million units are expected to be used to cover the “applied for” exemptions (those between 2 and 50 hectares) and a further 1.3 million will be used for the automatic exemptions for those under 2 ha. Thus only a total of 44.3 million are actually available for all other forest growers.
- 7.5 The exclusion of owners of small forest areas at the expense of those who own larger forests will mean the non-exempt owners will receive only 80% of the minimum 5% level that it was proposed they should receive.
- 7.6 Notwithstanding the proposed exemptions, where land has a higher and better use identified, the level of compensation currently offered (\$780 based on 39 units assuming a market value of NZUs at \$20/tonne/CO₂) is clearly inadequate when compared with a permanent deforestation liability of tens of thousands of dollars.

8. Offsetting for Pre-1990 Forestry

- 8.1 Kyoto rules require replanting of pre-1990 forest to be in the same location as the existing forest or else it is considered deforestation. It is widely accepted that the inability under the international rules to relocate a forest without penalty is nonsensical from both an atmospheric and an economic efficiency perspective.
- 8.2 The NZFOA has committed considerable time and resources to pressing the case for the rules for the second commitment to be changed to allow forest offsetting. We have worked with industry counterparts overseas and achieved significant recognition and support, including endorsement by the International Council of Forest and Paper Associations for such change. Our position is also aligned with New Zealand government negotiators with whom there has been close coordination of effort. We remain optimistic that, as long as the offsetting can be confined to plantation forestry and not adversely impact on biodiversity, the prospects for change post-2012 are positive. In the meantime the impact of the current rules on the industry, and other primary sector groups, remains very negative.

- 8.3 The New Zealand economy relies on dynamic land use. This is a prime example of where government has the ability to tailor Kyoto rules to ensure land continues to gravitate to the most economically and environmentally sustainable use. There is no, or minimal, inequity between sectors as a result of offset planting. It is for this reason that a number of primary sector groups formed the Flexible Land Use Alliance to urge that adequate compensation and land use flexibility be addressed.
- 8.4 The ETS (under Part 5, Subpart 1, Section 182) includes provision for the Chief Executive of the Ministry of Agriculture and Forestry to approve offsetting subject to certain conditions.
- 8.5 The NZFOA considers offsetting should be made operative now under the NZ ETS to provide additional compensation to pre-1990 forest owners. Offsetting should be provided in a way that ensures that it is carbon neutral and does not have an adverse impact on biodiversity.
- 8.6 If forest-offsetting was approved then those most affected would have a means of avoiding most of the cost involved in a carbon neutral relocation exercise. While there is still a significant cost in developing the land and recreating the associated infrastructure, this is more manageable and would be mitigated by the existing compensation units. Even with offsetting and the compensation units there is still expected to be a net cost and the permanent restriction over the land has not been removed.
- 8.7 Providing offsetting does involve a cost to the Crown – the reason The Treasury have consistently recommended it be rejected. However, it should be remembered that the reason the cost of land use change away from forestry is so high (800 tonnes/ha times the price of carbon) is not because of the requirements of the Kyoto Protocol but because the previous government introduced an additional rule into the ETS to prevent landowners replanting and then deforesting young trees to reduce their financial liability.
- 8.8 The ETS requires an owner to either:
- pay the full liability for the mature trees that were recently harvested; or
 - allow the newly planted trees to grow for nine years before deforesting.
- 8.9 This is not a Kyoto Protocol requirement. In contrast the Kyoto Protocol requires the landowner to be liable for release of carbon where, and when, the decision to change land use is taken.

8.10 Removal of the arbitrary nine year time restrictions on replanting would not be inconsistent with Kyoto rules. Indeed, if this was also combined with offsetting it would ensure a carbon-neutral activity that would not even be in conflict with the spirit of the Kyoto protocol and would be quite defensible internationally. Such a change would, of course, also create an economic incentive to make the decision to deforest a relatively short time after replanting, even if offsetting was also required. This perverse means of minimising the cost of deforestation provides yet another demonstration of the need for the existing international rules to be amended. Allowing the Kyoto rules to apply without restriction would also result in an unproductive use of resources and time and is not being advocated by NZFOA. If, however, the replanting restrictions are retained, then the government, rather than private individuals, should bear the cost of their decision to restrict the least costly option.

9. Inclusion of an Averaging Option for Post-1989 Forestry

- 9.1 At present post-1989 forest owners entering the ETS receive all the associated carbon credit less compliance costs and also face full liability for emissions at harvest.
- 9.2 Although the liability at harvest can be managed by retaining credits to cover this, it is likely that a significant number of the post-1989 credits available will not be taken up by forest owners. Typically these are owners of small forests or limited age class stands of forest who perceive there to be long-term risks associated with the price of carbon if they face a liability at harvest.
- 9.3 A relatively simple means of addressing this is to provide an additional option under the ETS regulations to allow credits to be earned only up to the long-term average carbon that the forest would sequester over its life. Credit for the carbon absorbed above this level would be held by the government. In return the forest owners who elected this method would not face any liability at harvest provided that they replanted.
- 9.4 Removal of the threat of an unknown cost at harvest is likely to encourage many owners of small forest blocks, including farm-foresters and farmers, to participate in the ETS and carry out new planting. The government is required to maintain a separate register in addition to those who are participating on a full credit, full liability basis, but it has the benefit of the credits prior to the harvest date. In addition measurement, reporting and compliance costs are likely to be less than the current option because it is a simpler system.

- 9.5 The NZFOA does not support all the credits being provided up-front at planting under an averaging option. This entails risk of permanence for the Crown and has the potential to adversely impact on both land values and the carbon market due to the likely boom/bust cycle of production that would result. The credits should, instead, be provided sequentially.
- 9.6 The current option should be retained alongside the averaging option for those who are in a better position to manage the flow of credits over time.
- 9.7 Thus, investors in new forest plantings post-1989 would have three options – no participation in the ETS, participation on an averaging basis, or full carbon sequestration and liability.

10. Force Majeure Clause

- 10.1 Government does not typically expect private individuals to cater for catastrophic events that can be considered beyond reasonable risk management provisions, or “Acts of God”. The compensation provisions associated with a foot and mouth outbreak in New Zealand are an example. Requiring forest owners to assume liability in perpetuity for carbon loss from all similar types of forestry events that could unpredictably decimate very large tracts of forests (as has happened with the mountain pine beetle in Western Canada or the recent bush fires in Victoria) is not reasonable. Unless this is addressed it will deter many from participating in the ETS.
- 10.2 It should be noted that Australia, along with Canada, is arguing in the international negotiations for unmanageable events to be able to be “factored out” of accountability and Australia has proposed to deal with these at a government level under its Carbon Pollution Reduction Scheme. This recognises that private insurance provision will either be unavailable, or prohibitively expensive.
- 10.3 Government should amend the ETS regulations to clarify that forest owners will not, individually, be expected to manage coverage of force majeure types of events, and should consider the Australian pooled approach to such coverage.

11. Timetable for Entry of other Sectors

- 11.1 The ETS is designed to be an all gases, all sectors, scheme. Until it is it will not function as intended.

- 11.2 By reason of being already included in the ETS, forestry is affected by any decisions determining entry of other sectors, particularly those involving land use decisions. At a recent meeting between the forest industry and government it was acknowledged that the ETS, and investment confidence in the sector, are inextricably linked.
- 11.3 For a trading scheme to function there must be both supply and demand for carbon credits. Without emitters facing an obligation to reduce there will be no market for those with the greatest potential to soak up carbon to be rewarded for doing so.
- 11.4 Inclusion of other sectors is required to maintain equity. New Zealand faces the cost of emissions regardless of whether emitters reduce emissions or not. Any delay in reductions by emitters must be met by some other sector of society – typically the taxpayer.
- 11.5 The NZFOA considers that New Zealand producing industries, including our own processing sector, must be afforded protection from unfair international competition where they are trade exposed; and they should have existing reductions from 1990 adequately recognised. Nonetheless the early establishment of a price signal and a level of commitment across the economy, is required for the ETS to function. NZ's international competitiveness will also be adversely affected if we do not pursue the most economically efficient means of reducing emissions. Delays in transitioning the economy will ultimately be more costly. As the National Party Blue Green policy notes “such a system would elicit the least-cost combination of emission reductions and forest plantings to absorb emissions”.
- 11.6 Delays on entry date, or signals from government that agriculture is to be protected indefinitely, work against the objective of establishing more planted forests on eroding, low-producing pasture land. Such delays or signals prop up the expectation of continuing land capital value appreciation. After policy certainty, it is the availability of appropriately priced land that is the single biggest constraint to new planting.
- 11.7 The NZFOA considers that the timelines for entry, that have already been extended once, should not be further extended. The 2 year extension granted to the liquid fossil fuels and transport sector should, in fact, be reduced to 1 year given that the rise in the price of crude oil that led to an apparent “on the fly” political decision to delay the entry of that sector has now reversed, viz:

2010	Stationary energy and industrial processes
2010	Liquid fossil fuels and transport (originally 2009)
2013	Agriculture, waste and all remaining sectors

12. Credibility of Units in the ETS

- 12.1 Clearly not all greenhouse gas units are created equal and this must be recognised by the NZ ETS in order to ensure credibility. The NZFOA supports the current exclusion of units that are clearly not “green” and therefore not equivalent to an AAU. The question of what does qualify as “green” and therefore acceptable is something that has not been adequately dealt with under the ETS and further clarification is needed. As a particular example, we consider that there are significant reasons not to include certified emissions reduction (CER) units from HFC-23 projects unless stricter rules can be put in place internationally. The widely recognised problem is that crediting the destruction of HFC-23 in developing countries that have an exemption to expand production until 2015 creates a perverse incentive for them to do just that in order to have a larger stock to destroy.

13. The Wood Processing Sector

- 13.1 Any retraction in the wood processing sector will have an adverse effect on planting investment. New afforestation and replanting of existing forests, even with carbon credits, only makes commercial sense on most of the available land in New Zealand if the logs can be sold profitably at maturity. This is facilitated by a strong and viable wood processing sector.
- 13.2 There has been little new investment in wood processing during the last decade, despite increasing supplies of available logs to process and MAF’s latest regional wood supply forecasts. If new entrants to wood processing are to be encouraged New Zealand must have cost structures that are competitive with other nations.
- 13.3 The generous provision of the free allocation assistance to heavy emitters (agriculture, stationary energy and industry) of up to 90% of 2005 levels until 2018 with a phase-out period till 2030 discriminates against firms that have made progress in reducing emissions from 1990. This is the case with many firms within the forest processing sector. Just as New Zealand is judged on its performance, whatever the circumstances, against its 1990 levels, so too should firms that have reduced emissions since that time.

14. The Form of an International Agreement Post-2012

- 14.1 New Zealand has been at the forefront of the international learning experience since ratifying the Kyoto protocol particularly with respect to Land Use Change and Forestry rules. It is clear that a number of rules, devised during UN negotiations at the eleventh hour, have had unintended and undesirable consequences. For many countries these issues are trivial or non-existent. This is not the case with New Zealand
- 14.2 Between now and whenever the next international agreement is concluded, the government should be negotiating much more strongly than in the past on getting recognition of the impact on New Zealand and insisting on more appropriate rules that do not work against sustainable land use, land use change and forestry (LULUCF) as practiced in this country.
- 14.3 There are some quite specific issues relating to forestry that need particular attention. As well as the ability to relocate forests, so long as the carbon sequestration potential remains the same, there are issues around the treatment of carbon in wood products post-harvest. The Kyoto Protocol exaggerates the liability of forest harvesting because the rules assume 100% release of CO₂ at the time the tree is felled. The reality is quite different because at least 15% - 20%, and possibly a lot more, of the CO₂ in the tree may be stored for a considerable period of time in the form of harvested wood products, either in long service use or in landfill.
- 14.4 The role of forest derived biochar, which serves as a permanent carbon sink when sequestered in agricultural soils, needs to be clarified, as this holds great potential for NZ, as it will not only underpin an important linkage between agriculture and plantation forestry, but because of the co-production of bio-oil during pyrolysis of wood fibre, links to the stationary energy and liquid transport fuels sector.
- 14.5 Again the NZFOA has been working closely with international forestry groups, particularly the Australian industry, in concert with our respective negotiators to pursue recognition of the contribution of harvested wood products.



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