



Submission by

NZ Forest Owners Association

- to the -

Parliamentary Finance and
Expenditure Select Committee on
the Climate Change
(Emissions Trading and
Renewable Preference) Bill

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1. Introduction

- 1.1. The NZ Forest Owners Association welcomes the opportunity to comment on the Climate Change (Emissions Trading and Renewable Preference) Bill. Forestry is an integral part of the solution for managing climate change and it is critical that the policies for the sector maximize that potential.
- 1.2. 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.
- 1.3. Tree growing is uniquely able to sequester carbon. For New Zealand to meet its climate change objectives, and targets, forestry needs to be encouraged. Achieving the government goal of an additional 250,000ha by 2020 requires enabling and supportive policy. Failure to do so will have very adverse consequences for New Zealand's ability to meet its future Kyoto obligations.

2. Summary

- 2.1. The NZFOA supports action on climate change and acknowledges the considerable work that has gone into developing the Emissions Trading proposals. The ETS is ultimately intended to be an all gases, all sectors, system and it is recognized that eventually there will be a reduction in emissions for other sectors, particularly those competing for land with forestry. The equity principles expressed are strongly endorsed.
- 2.2. That said the forest industry's preference has always been for a carbon tax instead of emissions trading because of the greater transparency, equity and ability to recycle revenue. This is still considered the most efficient means for government to meet its international obligations.
- 2.3. There are a number of positive aspects of the proposed scheme which the sector supports. The most obvious is the provision allowing post-1989 forest growers the option of participating in carbon trading. Any dilution of this policy would have adverse consequences on investment in carbon/timber afforestation given the reduction in returns and government's afforestation goals would be put at risk. That said, the policy could be improved by providing recognition of the pre-2008 sequestration by mid rotation forests which could also contribute to liquidity.
- 2.4. The fact that the system will be linked to the international market is also supported. This is because this linkage is more likely to achieve stability and robust price signals which the sector supports.

- 2.5. In contrast to its support for the post-1989 forest provisions, the industry remains strongly opposed to the imposition of a tax, without any ability to earn credits, on owners of pre-1990 forests (forests established pre-1990 even if replanted since).
- 2.6. The forest policy approach to pre-1990 forestry under the ETS is 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. It is not related to the impact of forestry on the atmosphere. It is not designed around the characteristics of the primary sector in New Zealand. It is not designed with the intention of maximizing the potential contribution of the forest and other primary sectors to the economy.
- 2.7. The current ETS provisions have created an artificial division between some forests that are almost identical and done considerable damage to confidence in forest investment in New Zealand. Despite protestations to the contrary, the deforestation tax has been introduced retrospectively. Owners have been denied the ability to factor in this significant restriction on land use and land value, at the time of investment.
- 2.8. The deforestation measures were proposed as a cap that was never expected to be breached. This has been documented numerous times. Twice, when the provision appeared as if it might be insufficient the cap was increased in order that the tax would not actually be applied.
- 2.9. A base level of deforestation is part of business-as-usual in the primary sector and is fundamental to achieving the optimal and sustainable use of New Zealand's productive soils. There is no reason to expect that removing the deforestation tax will result in an avalanche of deforestation above this low business-as-usual level. The rate of deforestation is something to be taken into account and managed but in a much less onerous and interventionist way than what is proposed. The vast majority of pre-1990 forests in New Zealand will be replanted even in the absence of a deforestation tax.
- 2.10. Because the measure is retrospective creating irregularities and distortions and because wholesale forest clearance is not going to happen, the deforestation tax is both unreasonable and unnecessary. It should not be implemented.
- 2.11. If a deforestation tax is proceeded with regardless, appropriate compensation should be provided. Within the ETS as proposed the NZFOA considers there are significant inadequacies in the estimation and allocation of the compensation offered in the form of deforestation units.
- 2.12. A more realistic measure of compensation should be based on the estimated historic level of deforestation (5.2%) over a period that matches the pre-1990 forest replanting decision time frames, and be made available to all pre-1990 non-exempt forest owners. It is important that the forest sector is transitioned, as is the case for other sectors, over a time scale that reflects the long-term nature of forestry commitments and decisions.

- 2.13. It is also inappropriate to reduce the level of deforestation allowance available to those who are not exempt by subtracting the exemptions from the total available to them. This has the effect of significantly reducing an already inadequate level of compensation.
- 2.14. To ensure that even the current level of compensation is equitably provided the compensation for the period 2012 to 2020 should be increased to 65 million tonnes. To ensure a level of transitional compensation that is related to the loss of value and permanent impost on pre-1990 forestry, and to accommodate forest-replanting decision horizons, a further 55 million tonnes should be made available for the period between 2020 and 2050.
- 2.15. Additionally, the ability to re-establish a pre-1990 forest in a different location so long as the same amount of carbon absorption will take place should be catered for. Any cost to government is recouped in the longer term, and even then it is likely only to be a cost for the first commitment period. New Zealand climate change policy needs to remain flexible when it is clear that the Kyoto Land Use and Land Use Change rules post 2012 are likely to change.
- 2.16. The ETS discussion document states that inter and intra-equity considerations have been prominent in considering what levels of assistance are appropriate. Such evaluations are never perfect and it is accepted that total equity is an unrealistic goal. However, on both inter-sectoral and intra-sectoral grounds forest growers consider that the treatment of pre-1990 forest growers remains significantly inequitable and therefore inconsistent with one of the key principles of the government's Emissions Trading Scheme.

3. Rationale for not imposing a Pre 1990 Tax

Kyoto rules are an unrealistic basis for national policy

- 3.1. The government signed an international agreement that creates an arbitrary point in time at 1990 and via domestic policy retrospectively penalizes anyone who planted forests prior to that date.
- 3.2. The "since 1990" restriction was introduced late in Kyoto negotiations due mainly to concerns related to the profile of slow growing northern hemisphere forests. The outcome – that no sequestration, even if it occurs after 1990, by forests planted before 1990 would be recognised does not reflect what the actual impact on the atmosphere is.
- 3.3. The outcome was a significantly worse position than New Zealand had been negotiating for. The forest industry advised, at the time, that this change was sufficiently bad to warrant New Zealand not signing the agreement. The government nonetheless ratified, and is now proposing that the cost, signed up to in the "national interest", is sheeted

home to individual forest owners. From being the leading proponent of forestry being included in the Protocol it is somewhat ironic that New Zealand is now the only country in the world that is proposing a carbon tax on deforestation.

Planted forests cannot be net emitters of carbon

- 3.4. Deforestation “emissions” from planted forests are not the same as other carbon emissions or tropical deforestation. Unlike all other emissions, those from plantation forests are merely a release of carbon that has already been removed from the atmosphere. The 1992 UN Framework Convention on Climate Change (www.unfccc.int) is clear that wood and wood products from planted production forests are “carbon neutral”. Biologically there can be no dispute that any plant material is simply borrowing carbon from the air.
- 3.5. A significant amount of pre-1990 forest has been established by the current owners on marginal farmland or coastal sand dunes. The net impact of the atmosphere of this planting, even if subsequently deforested, will in fact be positive due to the carbon that still remains in the wood products. It will certainly not be negative.
- 3.6. The linkage of credits and liabilities that applies to post 1989 forests, and which forest growers have always supported, is not being applied to pre-1990 forestry. The government’s position is that there are no credits associated with pre-1990 forests. Certainly the Kyoto protocol does not provide any credit but there is sequestration and it should be recognised.

The loss of land value is instant and large

- 3.7. The Government’s decision has the effect of expropriating without compensation the ‘alternate use’ value of pre-1990 forest land. The government discussion document acknowledges that the opportunity to profitably introduce new land uses will be reduced by the deforestation tax, and that there will also be an impact on land value. It concludes that most forest owners will face economic loss as a consequence.
- 3.8. The actual impact of Government’s decision on individual forest owners will be variable recognising that not all forest land has the same probability of being converted but the effect of Government’s decision is to impose a retrospective carbon tax liability of at least \$20,000 per hectare (assuming 800 tonnes of CO₂/ha at around \$NZ25/t CO₂ - the middle of the price range used in the Bill) – despite the best modeling, the actual quantum of this new liability is unknowable. In fact many forests will be deemed to be carrying more than 800 tonnes at harvest and the current European price is NZ\$30/tonne CO₂ (and approached NZ\$50/t last year) Thus the liability for many owners is likely to exceed \$25,000 hectare but may also exceed \$40,000 per hectare.

- 3.9. Approximately 1.2 million hectares of land is affected and the value of the contingent liability transferred to the forest industry is massive. The final future loss/liability cannot be known but on the above figures the liability will be at least \$24 billion dollars. In contrast government is providing about three-quarters of a billion in compensation.
- 3.10. The Emissions Trading Tax Issues paper prepared by the policy advice division of the IRD indicates that this liability will be a capital account transaction. Therefore, if the emissions liability bill is \$20,000 per hectare, then around \$30,000 per hectare of the forest revenue net of costs will be required to pay this bill assuming the forest owner's marginal tax rate is 33 cents. If the forest owner's marginal tax rate is 39 cents, \$32,786 per hectare of the forest revenue net of costs will be required to pay this bill. Forest returns are struggling to reach \$20,000 per hectare at harvest. The underlying land is therefore effectively stranded (locked in) to perpetual forest use with the value for alternate uses being zero or negative.

Inter-sectoral equity will be worsened

- 3.11. At present in NZ the true costs and benefits of the use of land for varying purposes are not fully reflected because the environmental consequences are largely not devolved. Forestry's positive externalities are not rewarded; for example its soil conservation benefits, water quality benefits etc. Conversely, farmers are currently not exposed to the cost of many of agriculture's negative externalities; for example greenhouse gas emissions, nitrification, water pollution, soil erosion etc. The outcome is a less than optimal set of economic signals influencing land use decisions. The land use change tax on pre-1990 forests would be an additional distortion added to the less than optimal economic signals.
- 3.12. Notwithstanding government statements about the importance placed on achieving equity, the pre-1990 treatment of forestry is not similar to that of other emitters, notably agriculture and transport. Agriculture will face no emissions reductions requirements until 2013; not even the relatively win-win requirement to apply nitrogen inhibitors. In 2013 it will be sheltered from 90% of its 2005 level emissions. Transport will be sheltered from 95% of its emissions in 2010. By comparison pre-1990 forestry will only be sheltered from 5% of its 1990 emissions as of the start of this year. It is hard to fathom how this can be regarded as "generous" as suggested in the public discussion document.
- 3.13. The single biggest driver of deforestation and the single biggest obstacle to new planting in New Zealand is the price of agricultural land. The current proposals with respect to the agricultural sector are likely to constrain the expansion of forestry even with the option of utilizing carbon credits or a grant. The administrative and monitoring costs associated with carbon credits are likely to mean that only forestry blocks that are several hundreds of hectares or upwards will be economically justifiable. The proposed policy will have the effect of driving up the value of bare / farm land and driving down the

value of forest land. Consequently the government goal of 250,000 ha of new forestry looks very ambitious.

- 3.14. Government's climate change policy is inconsistent with the statutory precedent in the RMA that resource users "avoid, remedy or mitigate the adverse effects of their activities on the environment". It is inconsistent with the philosophy of 'internalising environmental externalities' whereby the "polluter pays".
- 3.15. It is also unclear why only land-use change associated with forestry is proposed to be penalized in CP1. A land use change from extensive to intensive agriculture will result in a significant, and permanent, change in emissions, yet this appears not to be of sufficient concern to warrant any land-use change penalties.

Significant intra-sectoral inequity will be created

- 3.16. To the extent that post-1989 foresters are willing to forgo the alternative use value of their land they will get an up front (more or less) cash payment which will enable their timber production to occur at lower nominal capital cost than the pre-1990 forest owner. Even those post-1989 forest owners who choose to stand aside from their carbon credit values will enjoy the benefit of a tax free capital gain in land value which may compensate for a lower return on log value than could be sustained by the pre-1990 forest owner with no scope for capital gain.

The magnitude of expected deforestation is not huge

- 3.17. From surveys undertaken by the Ministry of Agriculture and Forestry (MAF), pre-1990 forest owners have indicated an intention to deforest 50,000 hectares over the five years of the first commitment period (2008-2015). The resulting liability is estimated at around \$600 million.
- 3.18. However, this assumes that none of the deforestation intended for the first commitment period has been brought forward. This is clearly not the case. The rate of deforestation, including a lot of immature forest, has been significantly accelerated by people seeking to avoid any potential penalty. Much of what was referred to in the MAF survey will already have been deforested by 2008.
- 3.19. The important point to note is that, even in the current environment of suboptimal economic signals, the great majority of the 1.2 million hectares in question will remain in forestry as this is still the most economically efficient use of the land. Remedying (over time) the suboptimal economic signals around environmental externalities will further drive most existing land in plantation forest remaining in that state.

- 3.20. The low, underlying level, of deforestation is unlikely to change if the deforestation tax is removed. The vast majority of forest has traditionally been replanted, and will continue to be replanted.

Maori forestry is also adversely affected

- 3.21. Maori forest leases and those Maori who have purchased CFL lands are adversely affected by the treatment of pre-1990 forest lands. The proposals appear to be contrary to the principles of the Treaty of Waitangi. They could well be open to legal challenge given the Treaty's guarantee of undisturbed possession of forests. Those Maori yet to settle grievances have the option of purchasing CFL at 'forest only' prices and are therefore not unreasonably hurt by Government's decision. Pre-1990 Maori and other forest owners will be competing for sales of forest products from CFL areas where the capital cost of land is lowered by Government's decision.

4. Inadequacies of the ETS deforestation proposals

- 4.1. Notwithstanding the fact that the industry opposes the application of a deforestation tax there are, nonetheless aspects of how the tax has been calculated and is proposed to be implemented that the industry believes is flawed. These aspects serve to make the deforestation provisions even more punitive than would otherwise be the case. If the government insists on imposing a deforestation tax despite the inequities, distortions and retrospective loss of value to individuals that it will create, these components need to be addressed to minimize the damage that a tax will do. The issues are as follows:

A. Exemptions should not be deducted from the allowance for those not exempt

- 4.2. It is accepted that the administration costs to government involved in measuring and monitoring deforestation of small blocks (less than 50 hectares and land containing weed trees) would be unjustifiably high. This is not a reason to further penalize owners of larger forests. The business-as-usual rate of deforestation provision for owners of larger forests should not be reduced because of the practicalities of dealing with owners of small forests.
- 4.3. The deforestation level that government has proposed will not be being made available to all growers. Of the 55 million units 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.
- 4.4. An allocation of 44.3 million units has the effect of reducing the deforestation allowance of those who are not exempt from 46 units/ha to 39 units/ha. Even though the owners of

small forests comprise just 1% of the total area, their exclusion at the expense of those who are not exempt will mean the non-exempt owners will receive only 80% of what government consider they should be receiving.

- 4.5. To maintain even the historic level of deforestation allowance for the majority of pre-1990 forest land that is not exempt, while providing the exemption for the limited area in small blocks, the total exemption should be set at 65m units rather than 55m for the period from 2008 to 2020.
- 4.6. In a further anomaly, the Bill states (Section 69) that of the 21 million NZU's in the first commitment period these will be reduced by one unit for every tonne of emissions that results "or that the Minister thinks is likely to result" from deforestation on exempt land (defined under sections 159 and 160 as anything under 50 hectares, or any area of land where the forest species is classified as a tree weed). This appears to be in conflict with "Forestry in an Emissions Trading Scheme Engagement Document" (September 2007) which states that the 0.8 million units anticipated as being needed for weed control during CP1 would not be deducted from the units allocated to landowners.
- 4.7. There is also an issue to be resolved over the clearance of forest for riparian margins. Where forest is required to be cleared and not permitted to revert to forest cover by local authority rules it would be unreasonable to impose deforestation costs on the landowner.

B. Forestry is not being transitioned over an appropriate time frame

- 4.8. The government has consistently said domestic policy should not slavishly follow the international agreement if this leads to a detrimental outcome domestically. Forestry operates on long-term investment horizons and policy needs to be based on medium to long-term objectives rather than focusing on relatively short international commitment periods. It is not clear how the date of 2020 was arrived at. Spreading 5% coverage of the pre-1990 forest estate over 13 years is not an appropriate recognition of the on-going level of harvested forest that has not historically been replanted on an annual basis.
- 4.9. Current estimates indicate that there are upwards of 1 million hectares of land in NZ currently not in forest that has forestry as the most economic efficient land use once all land use costs and benefits are fully recognised. Of this, 800,000 hectares is seriously eroding land. Given that the present estimates are that only 200,000 hectares of the existing 1.2 million hectares of pre 1990 forest could over time be used for another purpose, the bigger picture 'NZ Inc' position is that there is a real prospect of net increase in the total forest estate in the order of hundreds of thousands of hectares.
- 4.10. Clearly, a wholesale shift out of plantation forestry is not going to happen. The financial exposure to the government is limited and does not justify punitive regulations backed up by costly administration and monitoring.

- 4.11. The relative economics of land use have altered such that a transition to a new national land-use pattern is underway. This transition should be managed but not impeded. The outcome is a more sustainable primary sector which is in New Zealand's best interests.
- 4.12. The Government has accepted that 'NZ Inc' should accept the deemed emissions liability under Kyoto for the business-as-usual historical rate of land use change in pre-1990 forests. It has calculated this as 21 million tonnes in the first commitment period based on the "historical" rate of emissions.
- 4.13. The government does not have data on deforestation levels before 2001 but has estimated¹ that for the 10 years to 2005 the historical average annual deforestation rate was 5.2% of the area harvested. It is proposing to provide 'business as usual' cover of 55 million tonnes (equivalent to the same percentage of the total estate or 0.4%/annum) but only to 2020.
- 4.14. It would be more appropriate and sustainable to introduce a scheme that recognizes the on-going, but low, level of annual deforestation and that provides compensation out to at least 2050 based on a realistic assessment of the land that could realistically be deforested, and for government to signal a commitment to this time frame.
- 4.15. It has been estimated that around 200,000 ha of forest land could potentially be converted to other uses. This figure likely represents a practical upper limit. Some land could, but is unlikely ever to, be converted. Over the last few years the accelerated level of deforestation has reduced this pool still further. In the future environmental and emissions trading restrictions on land use alternatives to forest will further reduce the forest area that is a candidate for change.
- 4.16. Allowing for deforestation already completed, and the constraints on future land use change away from forestry it is nonetheless reasonable, and probably conservative, to expect that around 150,000ha has deforestation potential. This is the appropriate basis for determining and allocating compensation.
- 4.17. Spread between now and 2050 the estimate of up to 150,000 ha of land use change from forestry equates to approximately 3,500 ha/annum. At 800t CO₂/ha this is equivalent to a total of 120Mt/CO₂. Assuming the period to 2020 was adjusted from 55 to 65 million tonnes then half of the amount will have been allocated.
- 4.18. Extending the transition period to 2050 by allowing a further 1.83Mt/CO₂/annum for the 30 years from 2020, or the equivalent of 2,300 ha/annum for that period would bring the scheme into alignment with forest planning and harvesting cycles, particularly allowing for the longer rotation species such as Douglas-fir and provide appropriate compensation

¹ "Design Options for a Tradeable Deforestation Permit Regime"

<http://www.maf.govt.nz/climatechange/discussion-document/tradeable-deforestation-permit-regime/page-02.htm>

for those people, particularly Maori, who will not have the opportunity to change land use until land is returned and the existing crop has matured and been harvested.

- 4.19. The net cost to government after 2012 will of course depend on what is negotiated internationally with respect to Land Use Change and Forestry.

C. *Flexibility to relocate pre-1990 forests is unnecessarily constrained*

- 4.20. Land conversion from forestry to dairying (or some other non forest use) is not inherently undesirable, just as some conversion from erosion-prone hill country pasture, or pasture in nitrate saturated catchments or in cadmium loaded elite soils to plantation forestry is desirable. The New Zealand economy has benefited from land use being dynamic. Future flexibility should be maintained such that land gravitates to the most economically and environmentally sustainable use. For the most efficient use of land to prevail it is important that the cost and price signals approximates as closely as possible the true costs and benefits to society of that use so that the 'best' outcome results. It is the role of Government to facilitate this outcome, particularly given that 60% of merchandise exports are derived from land-based industries including agriculture, forestry, horticulture and viticulture. It is for this reason that a number of primary sector groups have formed the Land Use Alliance to urge that adequate compensation and land use flexibility be addressed if government insists on introducing a deforestation tax.

- 4.21. The ETS proposals do not allow flexibility to encourage replanting of pre-1990 forests. Under the proposed approach, temporary removal of tree cover will not face any penalty so long as the forest is ultimately reestablished in the same place. This recognition that there will be no net impact on the atmosphere should be applied regardless of the site of the replanting. This is a prime example of where government has the ability to tailor those Kyoto rules signed as a matter of international expediency to New Zealand conditions. Clearly it is in everyone's interest to avoid impediments to land use change that will result in greater net economic and environmental sustainability for the nation.

- 4.22. Deforestation 'opportunities' need to be compared with afforestation opportunities to get the sustainable land use balance right for NZ. Landcare Research estimate there is at least 1.5 million hectares of hill country, (the majority of which is unstable mudstone) in unsustainable pasture which would be better in forest cover (be it seeded in natives, or planted in exotics). Insisting that if a block of trees is reestablished elsewhere on land more suited to forestry it must still face the deforestation tax and then all the administrative and monitoring costs associated with getting credit for being new planting elsewhere is in nobody's interests. There is no or minimal inequity between sectors as a result of offset planting. In fact it is widely supported by the primary sector.

- 4.23. Under this option there will be implications for the timing of the Crown revenue and liabilities for the period 2008-2012. However, this is a timing issue, because:

- (a) the Government will receive additional Kyoto credits as the new trees begin to sequester carbon;
 - (b) the Government will receive additional revenue associated with the net economic benefits. CRA International undertook a comprehensive economic assessment of the conversion of forestry to pastoral land in June 2007 and found that for conversions such as those currently being done in the Central North Island, “the net benefits to society of dairy farming exceed those from forestry by \$767 per hectare per annum”.
- 4.24. A favourable outcome of the current negotiations over the post-Kyoto agreement would remove the problem relating to pre-1990 forests after 2012, hence limiting the time value of money cost of the solution to government to just the first five years.

D. The proposed distribution of deforestation permits is inequitable

- 4.25. While not specified in the Bill government has proposed to allocate deforestation units (NZU's) on the basis of land area. This assumes that all landowners will be affected equally which is clearly not the case. Those with higher value alternatives for the land will be most affected.
- 4.26. Modifications, where practical, to recognize the non-uniform nature of the impact would be appropriate, for example basing it on the rateable value of the land. It is important, however, to also recognize that all pre-1990 forest should be compensated to a certain level and thus a combination of approaches could be appropriate. As the Bill notes – “*all pre-1990 forest land value is likely to be affected to some degree*”.

5. Forests Planted post-1989

General

- 5.1. In general, the NZFOA supports the ETS provisions for post-1989 forests. The proposals provide much greater investment certainty and encouragement for forestry. The principle of recognizing credits and liabilities in equal proportions reflects the atmospheric impact of the forests and is appropriate.

Monitoring, measuring and compliance

- 5.2. There are a range of issues related to the operational aspects for those electing to participate in the ETS that need resolution. These include:
- (a) The ability to switch from a low-cost/low-precision measurement method to one involving more cost but better precision (or vice versa) in response to benefit/cost

changes of spending more or less on carbon measurement with changes to carbon price over time.

- (b) A facility to factor in higher wood density. Clones that exhibit 15% greater density combined with fast growth are now commercially available. Further genetic improvement in several species can be expected over time. Unless wood density is included in the carbon calculators the rate of uptake of these clones will be compromised, representing a lost opportunity for New Zealand. There is an urgent need for MAF to get carbon calculators out on the web so that members can make informed decisions.
- (c) The magnitude and basis of the penalty system given the uncertainty and openness to interpretation of the liability and offence provisions

5.3. These problems illustrate the complexity and extensive compliance costs involved in implementing a system that relies on a relatively precise measurement of carbon volumes.

Availability of credits to the ETS

5.4. It is likely that some of the post-1989 credits available will not be taken up by forest owners, particularly owners of small forests. The credit has nonetheless been generated by the forest sector and should be retained by the forest sector. It could potentially be used to lessen the impact of the increase costs of providing adequate level of compensation to pre-1990 forest owners.

Mid-rotation anomaly

5.5. On one point, there remains an inconsistency with the overall approach of the ETS and it has the potential to encourage undesired and unnecessary forest management responses. The area in question is those forests planted after 1989 but before 2008, especially between 1990 and 2000 (which because of a fall off in plantings soon after the year 2000, is the vast majority of the eligible forests). These plantations can be referred to as "Mid-rotation" forests given that they are part way through rotation at the onset of the ETS at 2008.

5.6. The forests, being post-1989 are eligible, but only the carbon removed after 2008 is able to generate credits under the ETS. Consequently, with nearly all mid-rotation plantation forests the losses at final harvest will be greater than the carbon sequestered after 2008.

5.7. The ETS scheme provides assurance that a forest owner cannot be liable for more credits than they generate which is consistent with the Kyoto rules (the so called "Fast-forest fix" rule). However, the forest owner is still denied recognition of the greater carbon stocks on site as at 1st January 2008.

- 5.8. It is recognized that because this gain is outside the first commitment period it is not recognized by the Kyoto accord. Nonetheless, because only a portion is being recognized it does create an incentive for the owners of such forests to clear them (without penalty) and then reestablish a new forest which will have all the carbon sequestration recognized. While this is rationale, it will result in a more mature and therefore faster carbon-absorbing forest being replaced with an immature forest with a lower rate of uptake.
- 5.9. This issue could be addressed by allowing the carbon that has been stored post-1989 but pre-2008 to offset the first part of the emissions at harvest. It would not require any greater level of data or information than normal forest inventory and carbon storage monitoring. Addressing it would also improve the availability, and therefore liquidity, of NZU's in the domestic market which would be preferable to having to consider foreign offsets of varying quality. This solution has been sought as part of the developing Emissions Trading System in Australia.

6. The Wood Processing Sector

- 6.1. Higher energy and fuel prices will significantly impact on the profitability of the wood processing sector particularly where their overseas competitors do not face the same obligations as is the case with much of Asia.
- 6.2. The proposal to provide assistance at the level of 90% of 2005 emissions actively works against firms that have made progress in reducing emissions from 1990 which is the case with the forest processing sector.
- 6.3. Any retraction in the wood processing sector will have an adverse effect on planting investment and further compromise government's climate change objectives.
- 6.4. 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.
- 6.5. 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. Measures to ensure this could include border tax adjustments on important exports.

7. The Second Kyoto Protocol Commitment period

- 7.1. The Government should be concentrating between now and 2013 on getting more appropriate rules into the next international agreement but also creating a domestic environment that leads over time to the net increase in the plantation forest estate of 800,000 hectares that should result from an economic efficiency perspective.
- 7.2. New Zealand has already shown leadership by being the first Kyoto country to include agriculture and forestry in our domestic climate change policies.
- 7.3. In order to be able to influence other countries to adopt rationale LULUCF policies that allow our primary sectors to continue to operate internationally in a competitive way, it is important to be able to advertise a model that is environmentally and economically sustainable.
- 7.4. There are some quite specific issues relating to forestry where New Zealand will need to negotiate strongly for change. 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 and the length of the commitment periods. As has become very obvious, five years is not an appropriate time frame over which to consider forestry rotations.
- 7.5. The Kyoto Protocol exaggerates the liability of forest sequestration because the rules assume 100% release of CO₂ at the time the tree is harvested. The reality is quite different because somewhere around 20% of the CO₂ in the tree may be stored for a considerable period of time in the form of harvested wood products.
- 7.6. The recognition under Schedule 4; Part 2 of the Bill of exported wood products that would constitute a "removal activity" is welcomed. Recognising harvested wood products under this definition is consistent with the true atmospheric impacts and "Atmospheric flows" approach under discussion in international UN fora. The NZFOA will support Government's implementation of this policy
- 7.7. In terms of negotiating the new LULUCF rules to apply from after 2012, it will be important to work with Australian negotiators who are likely to have similar objectives. Schedule 4; Part 2 of the Bill is in line with the recognition that will be sought by Australian forest owners under the Australian ETS for forest products.

8. Conclusion

- 8.1. The proposal to implement a deforestation tax should not be proceeded with. The lack of a threat of wholesale deforestation on the one hand and the wider range of problems that a retrospective deforestation tax will cause does not justify its introduction. Indeed

the Bill acknowledges that there is justification in a number of the criticisms that are made relating to pre-1990 forestry.

- 8.2. Pre-1990 foresters are concerned that the differential regulation of one part of the forest sector that produces a common, internationally priced, commodity could lead over time to perverse land management decisions. It will lead to a prolonged period of uncertainty, an increase in regulatory cost and possible litigation. Overall, the position of pre-1990 foresters including Maori forestry trusts and those who have purchased the freehold value of CFL's at greater than forestry prices is significantly compromised.
- 8.3. The current compensation for a significant, retrospective, and permanent liability and loss of land value is inadequate. Such compensation should take into account the underlying historical land use change that is part of achieving the best sustainable outcome from New Zealand's land bank. The total level of compensation provided to owners of pre-1990 established forests should be based on this. Exemptions should not be deducted from the compensation package of those who are not exempt.
- 8.4. If a deforestation tax remains in place, the total level of deforestation allowance should be at least 65 million units to 2020, with a further 55 million tonnes provided at a lower annual level to 2050. Ironically, this could well assist in reducing the deforestation level by restoring confidence in forestry investment. Future forest investment relies heavily on the sentiment of previous forest investors.
- 8.5. The government has said it will be generous in CP1. Under the current proposals pre-1990 forest owners are responsible for 95% of deforestation emissions from 1 January 2008. This is much more, and much earlier, than any other group. It is decidedly ungenerous.
- 8.6. The arguments presented in the Bill for not increasing the total deforestation allocation can best be described as place fillers. They are spurious and do not stand up to scrutiny. It is argued, for example, that if the allocation was increased it should be a deduction against the post-1989 forest land. Although the statement is repeated twice (page 50), no reasoning is given for drawing this relationship with the post-1989 forests. All post-1989 forest credits are already linked to an equal amount of carbon liability and it is completely inappropriate to suggest post-1989 forest owners liability should remain the same but their credit level should be reduced. The only other reason offered for not increasing the total amount is that it would somehow undermine government's objective of maintaining equity between the sectors. Given that the forest sector is facing emissions costs several years ahead of the agriculture and industrial sectors, and the level of historic emissions allowed is a fraction of that which these other industries will receive, this statement is a nonsense.
- 8.7. The ability to replant forests in a better location without penalty where there is no change in the impact on the atmosphere seems absurdly obvious, particularly where there are

good grounds for expecting land use rules that must be renegotiated for 2012 to address this inconsistency. The Bill is supposedly guided by an objective of “maintaining economic flexibility, equity and environmental integrity”.

- 8.8. Increased planting and a growing forest sector will be required if New Zealand is to avoid having an even greater emissions hurdle to overcome. This requires a positive and encouraging regime for forestry. By way of comparison, the international response to the issue of deforestation in developing countries has been to actively consider positive financial incentives to reward the retention of forests. That deforestation of natural forest is not an issue in New Zealand is attributable to the existence of the plantation estate. While the forest sector is not seeking to be rewarded for avoiding deforestation in the way that forest owners in developing countries are likely to be, nor does it expect to face excessive post-investment financial penalties, and loss of land value, without adequate compensation.

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