Submission

- to –

ETS Review 2011 Consultation
Ministry for the Environment
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2011 ETS Review

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Publishing details

FOA agree to its name and contact details being included in the summary of submissions.

Panel meetings with stakeholders

The FOA, as described below, is the sole representative body of the vast majority of the plantation forest owners in New Zealand. We consider that our perspective will add value to the deliberations of the review panel and request the opportunity to engage with them.

1. Introduction

This submission has been prepared by the NZ Forest Owners Association (FOA), on behalf of the New Zealand plantation forest industry.

The FOA is a voluntary organisation representing the interests of commercial forest growers, facilitating co-operation and co-ordination within the forest industry. FOA member companies collectively manage around 1.4 million ha of rural land, 80% of which is planted in plantation trees. We represent around 70% of all the planted forest managed in New Zealand. Our membership includes all the key post 1989 forest owners as well as the pre-1990 forest owners. The FOA has the mandate to speak on behalf of their combined interests. No other group provides this representation although our perspective is usually aligned with that of the Farm Forestry Association.

2. Focus of the FOA submission

The objective of the review is to provide the government with recommendations on steps that can be taken to ensure that, beyond 2012, the ETS

a) helps New Zealand to deliver its 'fair share' of international action to reduce emissions, including meeting any international obligations;

b) delivers emissions reductions in the most cost effective manner; and

c) supports efforts to maximise the long term economic resilience of the New Zealand economy at least cost.

The panel is required to review the operation and effectiveness of the ETS and, inter alia, give consideration to:

- Additional or new international obligations and links to overseas trading schemes
- The contribution of the ETS towards any targets that are in effect
- The types of emissions units permitted under the ETS
- Whether changes to the provision of allocation are necessary or desirable
- The appropriateness of any penalties and whether it is desirable to omit certain activities from the ETS
- The implications for New Zealand's emissions and the price of emissions units of any notification of the Crown's intention to allocate or sell New Zealand units
- The impact the forestry sectors inclusion in the ETS has had on biodiversity
- The effectiveness and efficiency of the NZ ETS including equity between sectors

These issues are all commented on in the attached submission under related headings and based on the forest sector's experience to date.

3. Summary

- The ETS is New Zealand's primary effort in meeting its international obligations and therefore our commitment to it will determine our credibility. Equally redefining "all sectors all gases" to allow permanent omissions of either is not credible
- In making international comparisons and determining fair share it must be noted that renewable energy targets exist in most other countries and the NZ ETS is not a cap and trade system - unlike the EU ETS – it is intensity based
- LULUCF negotiations are making good progress but whatever the outcome of the Kyoto negotiations international commitment will remain and efforts will intensify
- The forest sector has an important role to play and new forest planting is needed to smooth out emissions cycles but more than any other sector needs policy stability for investment because of the length of the investment commitment
- The risks to biodiversity from ETS driven forestry are small and overall the impact will be beneficial
- There are significant supply side risks for the ETS from certain "hot air" and industrial gas units. Controls must be introduced to restrict their entry into the NZ ETS if it is to remain functional
- There is insufficient evidence at this stage to warrant amending any of the timetables for entry or phase-out in the ETS particularly given the time that still remains before they take effect
- It is considered that the free allocation based on intensity, and the two for one subsidy on only those units above the free allocation, are providing the same type of relief. It would be more transparent and administratively efficient to have just the one measure of free allocation
- The price cap should not become a permanent fixture because it is distortionary and creates undesirable "gambling" on the future differential between it and the real world price. If it is continued then the same level of price cover should be provided to foresters at harvest. In the meantime the price cap should not be able to be exercised while NZU's are available at a lower price
- It is important domestically and internationally that agriculture faces a price signal from the NZ ETS. The signal is more important than the magnitude and the timetable of 2015 means there is no need to amend the entry date at this time. Monitoring and reporting should commence as scheduled next year
- There are some deforestation liability risks that can, and should, be addressed through additional policy to deal with force majeure events, offsetting and enforced deforestation

- If New Zealand fails to achieve modifications to the international rules to allow offsetting then the ETS should allow offsetting domestically anyway or the government should remove the 9 year rule regarding deforestation penalties – a rule that is not required by Kyoto obligations
- The option of choosing to receive credits equal to the long-term average level in a forest should be provided in the regulations
- Field monitoring of forest carbon should be an option made available for owners of forests less than 100 hectares in size

4. Maximising the economic resilience of the NZ economy at least cost, and undertaking NZ's fair share of emissions reductions

New Zealand's geographic location, low but relatively rapidly increasing population density, reliance on international transport and dependence on export trade mean that the more than many other countries we must ensure that our economy transitions to a lower carbon economy at least as fast as other nations.

Our emissions profile is unique amongst developed nations. Nowhere is this more pronounced that in the land use sector. Agriculture is the source of greatest volume of emissions and forestry has the greatest potential to sequester carbon and provide breathing space for the economy to transition. Balancing these different sides of the emissions equation and encouraging behavioural change and new investment decisions at a pace that that can be accommodated is the challenge. As noted in the Panel discussion document "the ETS is New Zealand's primary response to the challenge".

For a country reliant on clean green positioning for its food, fibre and tourism, the credibility of this primary response then becomes very important.

In terms of comparison of effort though it must be remembered that the current ETS is an uncapped intensity-based approach based on tonnes of emissions per unit of output. Thus, if emissions per unit of output are decreased, even if overall emissions rise, then the price can be avoided.

This is quite different to the classic cap and trade and is much less demanding on emitters. Those who it does perversely disadvantage are the early movers – those who have already made big emissions reductions per unit of output and thus have much less ability to make further gains. This description typifies key firms in the word processing sector.

One of the tasks for the review committee will be a consideration of progress elsewhere on emissions mitigation. Our conclusion is that the momentum globally continues to build. Comparing with other countries to determine our "fair share" is not straight-forward and the material provided in Table 4.2 of the review Panel's Issues Statement illustrates this well. The primary response in other countries varies. A limited number have an operational carbon market at either the national or sub-national level as their primary response. There are however, a range of other measures that have a significant influence on emissions reductions.

The relative position of Australia as New Zealand's key trading partner has been frequently referred to as an important indicator of how fast New Zealand should be progressing with its ETS.

As was the case in New Zealand Australia is grappling with the type of emissions reduction mechanism that is most appropriate. Both main political parties support action on climate change though the form of the response varies – as is also the case in New Zealand. There is therefore little question that additional action will be taken and, indeed, key industry players such as BHP and Wesfarmers have openly stated that they are making investment decisions on that basis.

It must be remembered that any further action taken by Australia will be in addition to the measures it already has in place.

This month the latest Garnaut review "*Carbon pricing and reducing Australia's emissions*" was released. On the basis of Australia's national interest Professor Garnaut recommends an emissions trading scheme with a fixed and rising price starting in the range of NZ$27 to NZ$41 and moving to a floating price without caps or floors in 2015. As in New Zealand, he also supports transitional assistance to emissions-intensive trade-exposed industries. Again, it should be noted that the ETS proposed for Australia is not an emissions-intensity based scheme but rather a cap and trade approach.

Since August 2009, Australia has had a target of having 20% of its electricity supply derived from renewables by 2020. In June this target was amended, notably with bipartisan support, to accelerate investment in renewable energy projects. Thus, there already is an emissions-reduction driver with an associated cost in place in Australia. In August this year the commonwealth government also launched a carbon farming initiative and the Garnaut report recommends that this be linked to the ETS to allow trade in carbon offset credits as is the case in New Zealand. Projects will begin to be assessed next year but already the first forward trade in Australian Assigned Amount Units (AAUs) has taken place.

In Europe a cap and trade ETS (as compared with NZ's intensity based ETS) was brought in 6 years ago and in 2009 had trades worth $US 118 billion – 64% of the world total. The third and most ambitious phase of the EU ETS is scheduled to kick in from 2013, with the aim of cutting emissions by at least 20% below 1990 levels by 2020.

As with Australia, the EU ETS represents only part of the response to emissions reduction and, arguably, not even its primary response. The renewable energy target of 20% by 2020 is expected to be achieved and represents a significant commitment to reducing emissions. In a recent survey report by Vivid Economics, for example, the renewable energy actions being taken by the UK amounted to an implicit price on carbon estimated at US$28.00 (NZ$37).

Renewable energy targets now exist in 73 countries worldwide and while New Zealand may have an intensity-based ETS its efforts to incentivise renewable energy thus far are minimal in comparison to many of these countries, though a National Policy Statement on renewable energy would be a step in the right direction.

In the US the Western Climate Initiative (WCI) involves several US states and Canadian provinces and aims to cut emissions by 15% below 2005 levels by 2020. Carbon trading is expected to commence in California and at least five other states by 2012.

There is also considerable activity in Asia. Japan will be introducing a compulsory emissions trading scheme from April 2013 which includes the use of offsets and plans to cut its emissions to 25% below 1990 levels by 2020. Amongst the non-annex one countries, India is already taxing imports of pollution intensive products like coal and will soon be starting a pilot ETS in Gujarat and Tamil Nadu, two of its most industrially intensive states. Fourteen model carbon markets are now operating in Korean cities and the government remains intent on introducing a cap-and-trade system for carbon dioxide as early this year. Even in China, carbon trading between state-owned power companies is expected to start this year. China's direction is clear from commitments it has made in its five year plan and, as the Panel discussion document notes, the Chinese government has committed to developing a nationwide scheme by 2015.

5. Additional or new international obligations and links to overseas trading schemes

We consider that a legally binding successor to Kyoto is an unlikely outcome from the end of year negotiations in Durban. It is more probable that an agreement built around the Copenhagen Accord which Cancun ensured is now embedded in the UN Kyoto process framework, will eventuate. Even then there will be significant challenges for countries in implementing agreed action by the start of the second commitment period. A gap is almost certain. FOA has been involved in the international negotiations since the outset and our view is that the Copenhagen pledges will provide sufficient momentum to ensure action and an international price on carbon i.e. there will be no lessening of commitment.

It should also be remembered that there are two binding international agreements – the Kyoto Accord and the UN Framework on Climate Change. The latter will continue regardless and has a range of obligations for the 194 countries who are signatories, including New Zealand.

It will be important to try to link the NZ ETS with other schemes such as the EU and the Australian system eventually but it is not critical that this happens immediately.

Regardless of the form of any international arrangement we are convinced that the negotiated rules applying to forestry will be applied. The progress on recognising the contribution of harvested wood products in addition to the contribution made by forests over the last two years in particular provides us with confidence that a resolution will be agreed by the end of the year. This will be as important for New Zealand as it is to foresters and is further reason why the policy environment must continue to send the appropriate signals to those who are capable of providing this benefit.

6. The contribution of the ETS towards any targets that are in effect – current forest estate projections and potential

Plantation forests can play a vital role in carbon sequestration to mitigate the effects of climate change and help meet our international obligations. In addition, and as stated above, it is becoming apparent that the contribution made by harvested wood products will also receive recognition in the future. Other important benefits include a biofuel role, already exploited heavily by wood processors, and a renewable building material which is becoming increasingly recognised internationally for its environmental characteristics and suitability for mitigating earthquake risk.

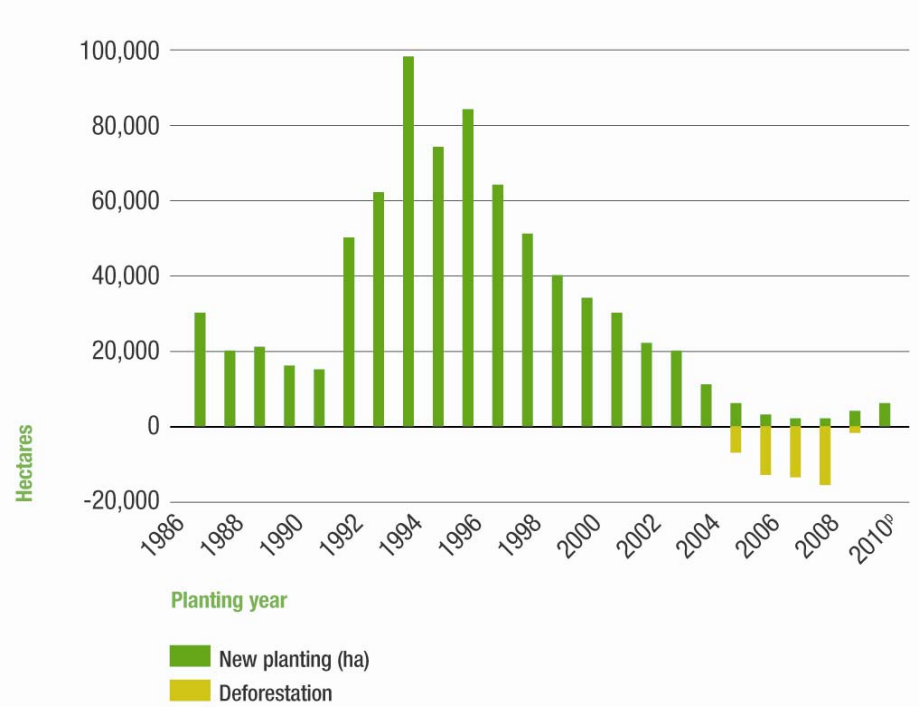
One hectare of plantation forestry sequesters approximately 25 tonnes of CO_2 per year. The establishment, and replanting upon harvest, of one hectare of radiata pine, using a regime typical of present day practices, will sequester approximately 112 tonnes of carbon in perpetuity. This can be viewed as a one-off movement of carbon from the air to the land surface. If the carbon in wood products is taken in to account then there is a further permanent reduction.

In 2005 New Zealand plantation forests removed about 25.5 million tonnes of carbon. In 2008 New Zealand's growing (plantation) forests were responsible for net removal of 14 Mts of CO_2e or 19% of the country's emissions.

To capture the carbon sequestration potential that forestry can provide New Zealand requires stable ETS policy. For several years leading up to 2008 forestry suffered from having insufficient carbon policy information on which to base significant long-term investment decisions. Forestry was eventually legally bound in to an ETS from 2008, but the subsequent review that lasted through 2009 meant that the future continued to remain unclear. This same uncertainty is now plaguing Australian investment even though both political parties have committed to taking action of some sort.

The uncertainty in New Zealand impacted new planting (new investment) and deforestation statistics as illustrated in the following graph which provides a similar picture to the statistics in the Panel's discussion document.

NEW FOREST PLANTING & DEFORESTATION

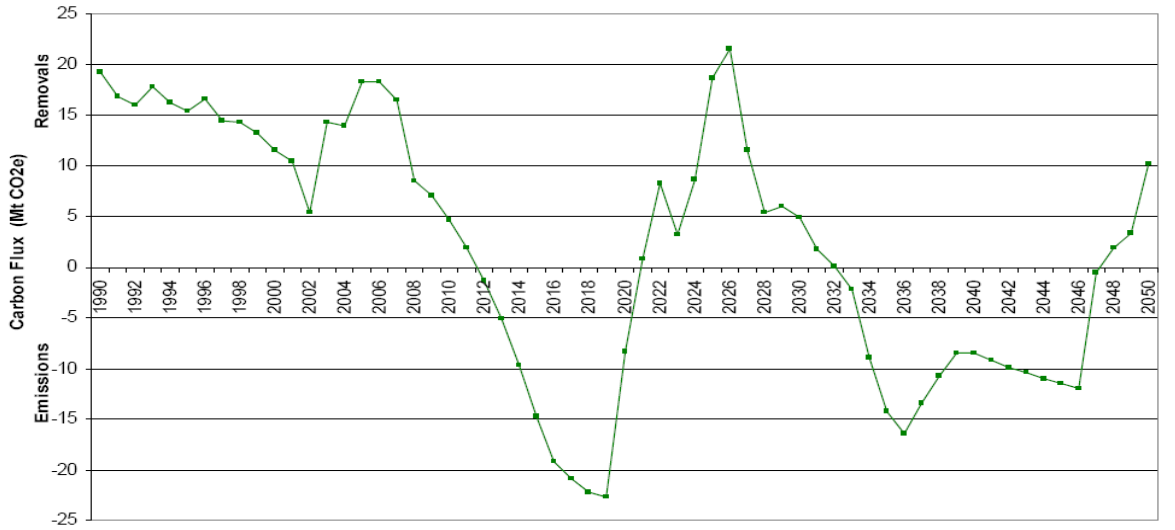


It also had a less visible, but very damaging impact on forest nurseries. Multiple times orders were placed on the basis of policy signals only for the orders to be subsequently cancelled. Several nurseries went out of business.

This year the new planting has shown a lift indicating some positive, although still muted, response to the now more settled investment environment. There is a lag affect associated with the nurseries while production is geared up which will necessarily constrain the level of increase. However, nurseries are expecting orders for 2011 to be up again on 2010 indicating that the positive recovery will continue so long as policy certainty and stability remains. There must be funding certainty for several years at a time to allow stability in planning. A forest investment commits investors to a planting process covering a number of years to complete (planning, land acquisition, land prep, etc).

The forestry cycle also reinforces the need to lift current new planting. At present New Zealand is benefitting from earlier pre-1990 planting booms. This "boom" crop is approaching harvest age and, at that point, under the current Kyoto rules, the carbon in the trees will be "instantly oxidised" and return to the atmosphere – meaning a lot of emissions - because the boom period was followed by a fall in new planting. Ordinarily these emissions could be offset by subsequent growth in the forest area but if this fell to low levels then there is insufficient sequestration to provide that buffer. This is illustrated in the following graph. Current new planting cannot prevent the current dip but it can prevent similar dips in the future.

PRE- PLANTATION NET REMOVALS



The take-away message from this for the Review Panel is that having waited so long to achieve something resembling a stable policy environment, it is very important that this commitment be maintained if forestry is going to feature as part of the solution.

As long as the commitment to an all sectors all gases ETS is maintained with a clear signal that there will be an increasing cost associated with carbon emissions including within the agriculture sector, then sufficient incentive is being provided for forestry to contribute to NZ emissions reductions.

7. Forestry impact on Biodiversity

The net benefit of forest planted under the influence of the Emissions Trading scheme should be beneficial. New forest planting will typically occupy marginal farm land that has a lower level of biodiversity that the plantation forest that will succeed it. Improved water quality, increased soil stability and a reduction in chemical use have been shown in scientific studies to result from this transition.

Potentially, there may be a limited number of areas where planted forestry could replace native forest and not contravene either the Forests Act or the RMA. NZFOA (and Farm Forestry Association) members are bound by a "Forest Accord" signed 20 years ago with the key environmental groups in New Zealand that prevents this but it is possible that this could take place legally on non FOA rural land.

This issue mirrors concerns that are part of the international discussions on REDD+ (Reducing Deforestation and Degradation).

8. The types of emissions units permitted under the ETS – supply side issues

The New Zealand ETS is currently very vulnerable to a significant oversupply of credits from dubious sources. This particular threat to the functioning of the ETS has the potential to overshadow all other supply side considerations and is a current threat.

"Hot Air" units

A number of eastern European and former Soviet Union countries whose economies contracted will be in a net surplus position during CP1 and have "hot air" AAUs to sell.

There is a question of whether these units should be allowed to be utilised by firms in the NZ ETS as opposed to what the NZ government may transact with another government. In 2009 and again in 2010 the Ukraine announced that it was looking at selling 50 million AAU's to New Zealand-based Tawhaki International for example. By comparison Russia will only transact with other governments.

It is not clear how many of these units will come to market or at what price but potentially several billion will be available (i.e. more than the combined obligations of all parties).

Their introduction will obviously reduce any abatement achieved by the ETS. Allowing this type of AAU in to the NZ ETS will also bring a credibility risk. We have already had this expressed to us from a number of sources domestically and internationally, and from both NGOs and government.

AAUs are not permitted to enter the EU ETS. Given that ultimately it is desirable for liquidity and consistency for the NZ ETS to be linked with other schemes this also becomes an important consideration.

Those countries potentially selling such units have recognized the negative perceptions around these units and ways to "green" the units have been devised. Hot air AAU's can be greened either through channeling revenue into environmental initiatives (emissions related and other) or by conversion into Emissions Reduction Units where the AAU's are used in a project that results in lowered emissions.

On the basis of the concerns above we do not consider that un-greened hot air units should be allowed to directly enter the NZ ETS.

Industrial gas CER units

Certified Emissions Reductions or CER are fungible with NZU and acceptable in the NZ ETS yet CER's produced from industrial gas CDM projects which involve reductions of hydrofluorocarbon-23 (HFC-23) and nitrous oxide (N2O) have very questionable environmental integrity.

The problem is that because the potential revenue from these credits is many times higher than the gas itself there is a suspicion production is being increased in order to then very cheaply destroy it. The methodology used has also been found to be flawed

and biased towards production in China and India. These gases have made up 75% of the CER units available to date.

The concerns have been sufficient for the European Commission to declare that CERs from Industrial Gas Projects will no longer be acceptable for use in the EU ETS after April 2013.

If NZ does not take similar action it is likely the NZ ETS will become a prime destination for these "homeless" units of which tens of millions/yr will be available. HFC-23 and N_2O CERs are already beginning to compete with NZUs and if left unchecked this has the potential to make the NZ ETS moribund and damage its credibility. Forestry investment is unlikely to gain momentum with the prospect of low-cost industrial gas CERs being allowed in the NZ ETS.

9. Allocation issues including the implications for New Zealand's emissions and the price of emissions units of any notification of the Crown's intention to allocate or sell New Zealand units – demand side issues

The ETS currently provides a transitional two for one subsidy whereby emitters are required to submit only one NZU for every two tonnes of CO2 emitted. The timetable for the phase out of this subsidy is the end of 2012. The Government has suggested that the provisions will be extended in the event that major trading partners such as the USA and Australia do not implement emissions trading schemes of their own before then.

The two-for-one subsidy works in tandem with the current cap on price of $NZ 25 meaning that effectively the maximum price that an emitter currently faces is NZ$12.50 per unit, but only where their intensity of emissions has increased. With the current price of NZU's around $4 below the cap then emitters are being required to pay between $10 and $11 per tonne of CO2 emitted. After allowing for the free allocation and the ability to reduce intensity we do not consider there is any basis to conclude that the phase out should be reviewed at this point. We consider, however, that it would be more administratively efficient to dispense with the two for one subsidy and simply provide the desired level of subsidy through the free allocation process.

The rationale of providing a ceiling of exposure to emitters to provide investment assurance that their business will not be exposed to unlimited upside carbon price risk while the carbon market is being established is accepted. That said, the price cap was not, nor should it be, intended to be a permanent fixture and cost to the taxpayer.

NZU's are trading at a discount to both the cap and the international price associated with CER's. It can be argued that the cap is already influencing the market price offered for forestry units. With buyers knowing that there is now limited upside price risk before the cap comes into play they have a greater incentive to hold out for a better price. It should be noted that by comparison foresters selling carbon face an uncapped liability at harvest and this should be of considerable concern to government.

Thus far the demand from emitters has been relatively weak even where the units are available at a significant discount to the price cap. The fact that the number of emitters who have felt compelled to go to the market thus far is low suggests that the impact on firms is manageable. This is undoubtedly related to the fact that the ETS is an intensity-based approach and thus there is the ability for emitters to avoid emissions liability through lowering their emissions intensity. In that sense the ETS is much less demanding than the EU ETS for example which is strictly cap and trade and, furthermore, does not allow firms to access forestry credits to help meet their commitments.

The price of CERs has been at or above NZ$25. If the price continues to hold above $25 for emitters who have purchased CER's at a lower price there is an incentive to sell them at a profit and purchase NZU's or, depending on the price of NZU's, to go to the government and replace them at the price of $25. It should also be noted that the restriction on exporting NZU's is scheduled to cease in 2012. There is thus some rationale to increase the price cap to avoid the government unintentionally providing an arbitrage opportunity for third parties effectively selling internationally-traded CER's at a capped price of $25NZ – i.e. subsidising the world market.

There is incentive in fact to buy CERs rather than NZUs because of the potential for profit making underpinned by the government cap whereas the price cap rules this out for NZUs and therefore makes them relatively less attractive. While this is economically rational behaviour it works against providing a positive investment signal to the creation of further NZUs from forestry, i.e. the cap works as a disincentive to forestry investment.

It is important, as a minimum, to reinforce that the price cap is a transitional measure. When first established the cap was sufficiently above the market price as not to have an impact. Since then the market price has approached the cap price. If the cap is not removed as timetabled then it will increasingly distort the market with constant second guessing about when and what it might be adjusted to next.

On the basis of the above factors around risk and degree of impact we consider that the measures intended to be transitionary should remain transitionary and be phased out on schedule. If a price cap is kept in place then the government should be prepared to offer the same level of guaranteed inflation-adjusted price protection to foresters at harvest.

What is not stated as policy at present but should be, in our view, is that the government will not allow any price cap to be accessed by emitters whilst NZU's are available at a lower price. If this is not the case then the potential exists for the taxpayer to unnecessarily bear a higher cost.

10. Equity between sectors and groups

Agriculture

Agricultural emissions, methane from enteric fermentation and manure management as well as nitrous oxide from animal effluent and fertiliser, are not legislated to enter the scheme until the 1st of January 2015. Monitoring and reporting of agriculture emissions is due to commence from 1 Jan 2012. We see no reason at this point to change either of these dates. The entry date is still some 4 years away and well into the second commitment period.

The NZ ETS has been touted around the world as an all gases, all sectors system. It is important that this is adhered to. When agriculture comprises such a proportion of our emissions it is difficult to see how it could be excluded. New Zealand will be expected to provide leadership and demonstrate commitment in this area and is doing so through the commitment to aagricultural research and leading the global coalition.

Indeed the Parliamentary Commissioner for the Environment went further and concluded that there is insufficient evidence to justify leaving agriculture out of the NZ ETS until 2015. This was supported by the Institute of Policy Studies view that delayed entry would actually be detrimental to the sector's competitiveness.

We do not accept the argument that nothing can be done to reduce agricultural emissions and, in fact the Review Panel information paper notes some of the actions being undertaken by other countries. Forest offsetting is one obvious means that is available to many landowners without adversely affecting productivity. Some farmers have been quick to take advantage of the benefits of the ETS for marginal hill country - a lot more could be planted. Nitrogen inhibitors, stock management, biofuel use and nutrient monitoring also offer potential but are being insufficiently applied at present. This month New Zealand scientists proved in field trials that emissions of nitrous oxide (15% of New Zealand's total GHG emissions) from animal urine can be cut drastically (up to 70%) by adding biochar to the soil.

It is acknowledged that significant challenges exist and while the transition period for agriculture to face a price signal must be managed very carefully for the sake of the national economy, it is nonetheless equally important that the signal be sent that agriculture will be part of the ETS. To an extent we will not know the full extent of what can be done to mitigate agricultural emissions until there is a price signal. The magnitude of the signal is less important and even an initial price of zero will still be an important policy signal. Conversely, excluding agriculture will send the wrong signal and is material to forestry as a sector that competes on price for the same land base. Whatever the policy is for agriculture will affect forestry.

Monitoring and reporting of agriculture emissions is needed by both the sector and the government and should commence from 1 Jan 2012.

Under as business as usual scenario (i.e. no mitigation behaviour) the following impacts on agriculture were estimated:

Emission price scenarios: change in average payout relative to business-as-usual scenario - with no reductions in emissions		
Possible Impact in 2013 (90% of 2005 free allocation)	$15/t CO_2-e	$25/t CO_2-e
Dairy	–1.0%	–1.6%
Beef	–0.2%	–0.3%
Sheep meat	–0.7%	–1.2%
Venison	–0.1%	–0.2%

We agree that there is merit in giving consideration to a second "Projects to Reduce Emissions" approach, as raised in the panel's discussion paper, although this should be considered in the context of the total assistance provided to agriculture. In general we consider there is probably more the government can do for small to medium sized businesses to facilitate energy efficiency and emissions reductions.

11. The appropriateness of any penalties and whether it is desirable to omit certain activities from the ETS – deforestation penalties

a) Force-majeure

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. Requiring forest owners to assume liability for events that could unpredictably decimate very large tracts of forests (as has happened with the mountain pine beetle in Western Canada) is not reasonable. Unless this is addressed it will continue to act as a deterrent to forest owners participating in the ETS. Australia, for example, has proposed to deal with these at a government level under its carbon pollution reduction scheme.

It should be noted that Australia, along with Canada, is arguing in the international negotiations for force majeure events to be able to be "factored out" of accountability. It is likely however that the scale of such provisions at a national level will not cover most of the events that individual forest owners would still consider catastrophic.

Government should amend the ETS regulations to clarify that forest owners will not be held directly responsible for force majeure types of events. The industry does not expect government to absorb the cost of this but recommends, as proposed in Australia, that a national scheme be provided utilising a small percentage of the credits to provide insurance cover.

b) Offsetting

Kyoto rules require replanting of pre-1990 forest to be in the same location as the existing forest or else it is deemed to be 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 a production efficiency perspective. New Zealand is highly reliant on maintaining the productive efficiency of its rural land and being able to respond to market signals. The international rule has been costing New Zealand productive efficiency without any justification and achieving this allowance internationally is a "must have" for New Zealand.

The FOA 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 support, including endorsement by the International Council of Forest and Paper Associations for such change. Our position is also aligned with government negotiators with whom there has been close coordination of effort. It is clear that offsetting can be confined to plantation forestry and not adversely impact on biodiversity.

Whilst offsetting is not a costless exercise it would help mitigate the impact on those most affected and who have only been offered a level of compensation that equates to around 5% of the liability they now face even with the second tranch of compensation units available post 2013. Indeed, for on-going confidence in the sector, it is important the government signal as soon as possible that they remain committed to provide the full amount of compensation.

If New Zealand is denied the ability to amend the international rules and the government is not prepared to provide offsetting without such a change, then the government should remove the requirement to nine-year replanting restrictions.

Providing offsetting does involve a cost to the Crown. 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 liability.

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 and then pay the liability associated with the actual carbon in the trees.

Nowhere in the Kyoto Protocol is this stated as a 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.

While it is clearly not desirable for time and energy to be expended on trees only to have them ripped up again, this does present a cost-effective and legal means of meeting Kyoto obligations under the rules as they currently stand.

The timeline restrictions on the replanting of pre-1990 forest are self-imposed. Government should either remove rules that are not required to meet Kyoto obligations and which prevent landowners legally reducing their liability, or the government should bear the cost of such domestic rules themselves.

c) Enforced Deforestation Liability

Discussions are currently underway between a range of parties including the government, industry, local authorities and environmental groups over the potential development of a National Environmental Standard for plantation forestry. One of the issues that has come to the fore is the liability associated with a requirement to increase forest setback areas. Such a requirement would prevent replanting of these areas and trigger the deforestation penalty provisions of the ETS.

The ETS needs to specify who has the liability for such deforestation. The FOA asserts that the liability should rest with the authority that is requiring a change of land-use away from forestry.

12. Desirable changes to forestry allocation to improve efficiency and effectiveness

a) Introducing the option of receiving the long-term average level of carbon credits

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.

Although the liability at harvest can be managed by retaining credits to cover this, it is likely that a reasonable number of the post-1989 credits available will not be taken up by many forest owners of small forests or of limited age class stands of forest. This is because of they perceive there to be long-term risks associated with an unknown price of carbon at harvest.

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 (as opposed to the current option of following the carbon curve). Credit for the carbon absorbed above the average 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. It would also remove the risk associated with premature surrender of carbon units following a catastrophic event. This option was proposed under the Australian Carbon Pollution Reduction Scheme.

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 enter the ETS. 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.

The current option should be retained for those who are in a better position to manage the flow of credits over time. Thus, investors in new forest plantings post 1989 would have three options – no participation in the ETS, participation on an averaging basis, full carbon sequestration and liability.

The draft Australian ETS proposes that carbon units can be received from reforestation - but only up to the average long term carbon stock. Carbon units do not have to be surrendered following harvest or a catastrophic event provided the crop is re-established.

b) Reporting requirements for forests under 100 hectares

Regulations just introduced prescribe compulsory field measurement of carbon for landowners with 100 hectares or more of forest participating in the ETS on the basis of greater accuracy and fairness.

While this is supported, it leaves a question of fairness and equity over those with forests of less than 100 hectares. These owners will have their carbon calculated on the basis of average look-up tables. Some within this group will have significantly more than in the look-up table and the FOA position is that these owners should have the option of incurring the additional compliance cost of using the more refined field monitoring that will be used by the larger forest owners if they consider it is worth their while. Technology, chiefly LiDAR which is airborne radar scanning, is utilised by government for its own economically efficient monitoring and could also be utilised by forest owners with MAF support for mutual benefit.