



Submission

- to -

ETS Review Consultation
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Submission on the 2012 Consultation Document "Updating the New Zealand Emissions Trading Scheme"

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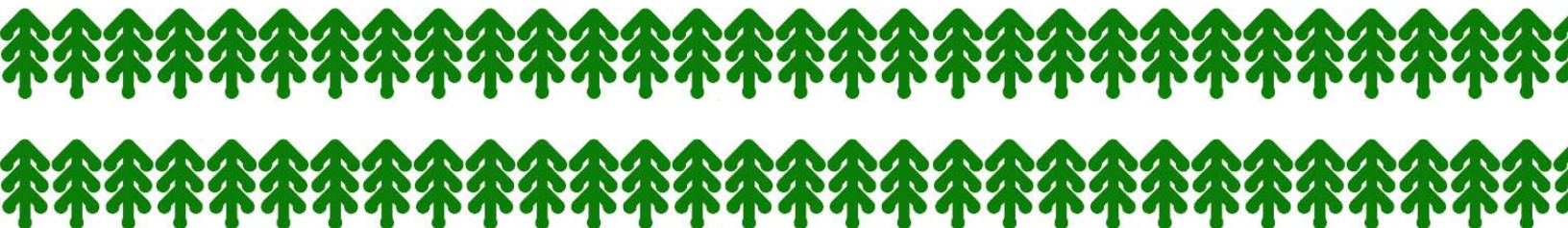


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1. Introduction

The New Zealand Forest Owners Association (FOA) represents the commercial plantation forest growing sector of New Zealand and FOA represents over 200 members with ownership over some 1.2 million ha of plantation forests. These estates comprise around 70% of the total forest growing sector in New Zealand and comprise small owners represented individually or through affiliation with the NZ Farm Forestry Association (NZFFA) through to the major corporate and timberland investment interests.

2. Summary

The proposed changes in the document that will increase the incentive for action on emissions reduction and reduce price volatility are essential for the ongoing viability of the ETS and are welcomed. Unfortunately, on many important issues critical to forestry and forestry investment, the document is merely a placeholder that speaks of changes to come but provides no further indication of what they are or how they will operate.

For pre-1990 forestry the document shows a clear bias in the options presented that suggests the consultation will have minimal influence on the outcome.

The document presents offsetting as a panacea for all pre-1990 forest owners to avoid most of the impact of a deforestation liability cost and risk. This is not true and demonstrates a lack of analysis and understanding of the forest growing industry. Furthermore, there are significant costs involving in offsetting. The FOA considers that the real (as opposed to the theoretical) opportunities to utilise offsetting will be very constrained. We consider it inequitable and unjust to remove compensation from all forest owners on the basis that a few may be able to relocate, but not remove, their deforestation liability through offsetting.

3. General

The forest sector has been in the NZ Emissions Trading Scheme since 2008 – considerably longer than any other sector. Since that time the ETS has enjoyed very little stability and has been characterised by ongoing review and change. While some of this is necessary in an emerging scheme, much has been driven by political expediency. The forest sector, which all agree is a vital component of the ETS, is one that needs significant investment certainty because of the long investment horizons and yet the ETS policy has failed to adequately provide for this.

We contend that the NZETS has failed to achieve its objectives as reconfirmed in the consultation document viz. that it has not brought about behavioural change and delivered emission reductions.

Further, we do not agree with the assertion in the document that “the scheme is having positive impacts on investment in forestry”. There was a brief period where there was an increase in new forest planting stimulated by the ETS but this was short-lived.

There has been a significant focus on ensuring that the market is not over-cooked i.e. that emitters do not face unfair competition and an excessive burden from their ETS obligations. This principle is supported although the generous subsidies, price-cap and phase-out timetables, have meant that it has been possible for some emitters to simply pass on their obligations to the taxpayer and avoid any direct cost themselves.

What has been missing is a counter-balancing concern to ensure that the market is not under-cooked i.e. that there is a sufficient price signal to stimulate behavioural change and encourage supply of offset units in to the ETS. The lack of such safeguards has contributed to the ETS price falling to a level where it is having no influence on forest investment.

The discussion document points to a number of developments that could potentially address this such as cap and auction and restrictions on international units. This focus on mechanisms to bring stability and ensure a fully functioning domestic carbon market is welcomed. However, without considerably more detail on these conceptual approaches it is not possible to know whether they will be effective. We encourage the government to provide the detail on these mechanisms as a matter of urgency. Until this detail is known the uncertainty will continue to act as a deterrent to participation by forestry in the ETS.

4. Transition Phase

“One for two” surrender obligation

We are pleased to note that the government proposes to accept the recommendation of the review panel to phase-out of the “two for one” subsidy. The price cap already provides a strong level of protection for emitters. When combined with the two for one subsidy, this effectively meant emitters are facing a maximum price of \$12.50 although in a number of cases we believe that the maximum cap price may have been passed on to consumers – meaning the emitters have actually profited from the ETS.

Fixed Price Cap

We note that the government introduced the price cap to protect against price volatility and has rejected the panel's recommendation to lift the price cap from 2013 because of the "uncertain international situation". It should be noted that forest owners entering the NZ ETS can own credits and the corresponding liabilities. This proposal will mean that any such forest owner selling in to the NZ ETS will have their price capped at \$25 until at least 2015. However, no such cap will apply to their liabilities which will be determined by the international market price. The net effect is increased uncertainty for forest owners.

We also note that there is no reciprocal discussion of a floor price. The UK government recently announced a floor price for carbon of £16/t CO₂ to apply from April next year. This is expected to go to £30 by 2020. Similarly, Australia will also be applying a floor price. New Zealand appears to have a myopic focus on only one side of the supply and demand balance in the market.

5. Restrictions on International Units

As the discussion document points out, restrictions on the use of international units has been notified under both the European and Australian emissions trading schemes with the latter imposing surrender obligations to ensure a degree of domestic action. These are the two most important carbon trading markets for New Zealand and alignment with the Australian system is particularly important given the plan for integration by 2015.

The inclusion of a similar constraint in New Zealand would not only be consistent, but we argue that it would be essential if the New Zealand market is to provide any reassurance that domestic trading will occur. As such the FOA welcomes the intention of government to introduce such control, but the lack of detail is a significant concern.

In assessing the suitability of units entering the NZ market it would be appropriate to consider issues such as additionality and whether the units emanate from countries that have clear national targets and a record of compliance as New Zealand does. This becomes even more relevant if New Zealand is not signed up to the second commitment period.

Unlike the clarity that exists for the Australian and EU ETS participants, the New Zealand consultation document provides no further details on what level of control will exist. Furthermore, it leaves the setting of such controls at the Minister's discretion. This proposal means that there is far less certainty with the NZ ETS than in Australia and this inconsistency could become a problem for alignment between the two systems.

As with the suggestion of a cap and trade mechanism, it is not possible to make a judgement about the usefulness until further detail is provided. The document suggests that this will be some time way. For forest growers this will add to the uncertainty and lower the attractiveness of the ETS.

6. Forestry

A significant proportion of the document is devoted to the treatment of pre-1990 forestry.

It should be remembered that the NZ government agreed to the establishment of the international Kyoto rules which meant that carbon sequestered in growing forests that were established before 1990 was not recognised. Not only this, but where these forests were replaced by another land use, the country incurred the full liability of all the carbon that was in the forest when the decision to deforest took place.

The government was not obliged to impose this liability domestically on forest owners, but it did so. It could have absorbed liability as it has done for agriculture and other emitters, but it did not do so.

Furthermore, the NZ government chose to impose an additional restriction on pre-1990 forest owners that does not appear in the international rules. This is the requirement that any pre-1990 forest that undergoes land use change where the forest is less than 9 years of age, will incur the full liability of the previous rotation at maturity. No other country has applied such a rule. Without this rule the potential cost impact on pre-1990 forest owners would be reduced enormously. The point is that the NZ government has chosen to place these restrictions on owners of forests established pre-1990, when it was not obliged to.

The result, as has been acknowledged, is an understandable devaluation of those forests. Without incurring a significant financial penalty they are locked in to being forests for all time. It is undeniable that many current owners of such forests would not have purchased them, often as retirement investments, had they had prior knowledge of the pending devaluation.

In response, the government has provided a low level of compensation for this permanent liability. The levels provided are 60 units if the land was purchased pre-September 2002 or 38 units if it was purchased post-2002. This distinction is an arbitrary decision which has no justification. The argument is that by September 2002 the government policy was clear. FOA can point to government papers dated post this period that illustrate that policy was far from settled.

The compensation levels of 60 and 38 units per hectare compare with the deforestation liability faced of approximately 800 units per hectare. In both cases only one-third of this amount has been provided thus far to those that have applied for it (and not all have). The remaining two-thirds tranche are due next year.

The discussion document now proposes options that either partially, or completely, eliminate this second tranche on the basis that offsetting was approved under the international rules at the latest UNFCCC meeting in Durban.

The FOA has worked alongside the government negotiators for several years to help bring about the offset rule change achieved in Durban and have been advised that this support has been critically important. The FOA provided this support because, although the available opportunities are restricted, it is clearly illogical to preclude offsetting for those who may be able to undertake it and there are instances where more sustainable land management can be achieved because of the flexibility.

The FOA also supported change because it imposed an unjustified cost on the country. Suggesting, as a consequence of removing this national liability, that all pre-1990 forest owners could lose two-thirds of their 5 % level of compensation because offsetting is now available for use by a limited number is perverse.

The reason we consider that it would be unfair to remove compensation from all pre-1990 forest owners is that offsetting still comes at a significant cost. As it stands, the statement that "Offsetting significantly reduces the cost of pre-1990 forest land deforestation" is simply not true. It should state that offsetting can significantly reduce the cost of pre-1990 forest land **in some circumstances**. For offsetting to even be contemplated many conditions will need to be met first. A couple of these have been raised in the discussion document, most have not. The following are relevant:

- In many instances suitable land for offsetting that can be assimilated into an existing operation will not be available either because of the size of the area available, its geographic location, road accessibility, distance from mill or port etc;
- In other instances suitable growing land may be available but not land that can satisfy the requirements referenced in the consultation document that is "of at least the same area and can achieve the same carbon stock as the original cleared forests within the usual rotation length". It is highly likely that the land purchased will be of lower productivity and therefore a greater area of land will be required to be purchased to compensate for the area converted. Even assuming the growing conditions are the same it is unlikely the hectares for sale will match the area sought meaning, again, that surplus land will have to be purchased.
- Some land that might be suitable if the forest could be retired as a carbon store, is also excluded because the land must be planted and not allowed to naturally regenerate. Normal plantation forests cannot be just abandoned as ultimately the trees will topple en masse and so access and harvesting are key criteria;

- The land for offsetting must be eligible as post-1989 land and this effectively means farmland unencumbered by ETS land use restrictions. The transfer of an ETS encumbrance to this land through offsetting means, not surprisingly, that there will be an instant loss of land value. No workings are provided for the figures in the consultation document, but we are confident this loss of value has not been included;
- Even if suitable qualifying land can be found there will then be costs in bringing that land to the same operational status as the area deforested. Even “clean” land will likely require pre-planting preparation. The most significant costs will be those associated with re-establishing management and harvesting infrastructure such as roading, culverts, bridges etc which would all have been present on the previous forest land. “Cheap” alternative land will typically be land where these costs will be significantly higher because of the topography and accessibility.

Even if all these conditions are satisfied and there is financial merit in offsetting, the fundamental point that the document omits to mention is that once the offsetting exercise is complete, the landowner will have simply moved a permanent liability from one location to another. At any point in the future if the landowner or future owner wishes to use the land for another purpose, then all the same conditions will once again have to be satisfied to allow offsetting to avoid the deforestation liability. And once again, this will simply be relocating the liability to another property.

Many pre-1990 forest owners are “Mum and Dad” forest investors who will have invested for retirement in a single age class of trees with the intention of selling out of the property post-harvest. Offsetting, and continuing with forest management, is unlikely to be a suitable option for such investors.

Many pre-1990 forests are on Maori-owned land, established at the behest of the trusts set-up to manage business on and act as kaitiaki over the lands. Over and above the economic difficulties of off-setting, it would be quite contrary to their tikanga to purchase or rent other lands to which they do not have whakapapa or mana whenua associations – which is what would be required to create an off-set.

The overriding message is that in considering the possible savings from offsetting, it is essential to take in to account the probability of offsetting actually occurring. It is clear that for all pre-1990 forest owners the opportunities are very limited for a variety of reasons, not just the considerable cost involved.

Another fact that is also very relevant is that the change in the international rule immediately adds to the net benefit position the government is in from forestry. There are a significant number of forest owners (both post-1989 and pre-1990) who have not taken up their entitlement under the ETS. By default any credit accrues to the government. Previously this was able to be used to defray the cost that government faced from allowing offsetting when it was not allowed under the international rules. There is now no such cost, but government is still benefiting from the forest credits. This benefit should be taken into consideration.

These are all the reasons why compensation for a permanent loss of value is just and fair and why the removal of compensation is just the opposite. Compensation, even with offsetting, remains inadequate.

The option of offsetting is widely viewed from the perspective of fostering land use flexibility for those forest owners who have an opportunity to “upgrade” the use of underlying land. An example of this is the conversion of forest land to pasture. We support the introduction of an offset option in that it will, in some cases encourage land use conversion which may contribute to a better overall economic outcome for New Zealand. As mentioned above however, the option cannot be exercised without incurring material additional costs to the landowner.

There are however, instances where the removal of the second tranche will discourage land use change and this is particularly true in cases where forest owners will be incentivised under the prospect of material financial penalties (deforestation liabilities) to persist with practices that are not the most optimal that could be achieved. Many planting boundaries which exist today were established with the objective of utilising as much land in a particular title for productive purposes. Within many large and medium sized forest plantations there are areas – often steep sensitive lands – which would be better left unplanted following harvesting thereby avoiding a situation where following a period of 27 odd years they will be harvested again with the consequent soil disturbance which harvesting entails.

Although a second tranche of 24 NZU’s represents only about 3% of the deforestation liability a forest owner would face if he chose to not replant a particularly sensitive area, this issue should be viewed from a different perspective. A large owner, say with a pre-1990 estate of 10,000 hectares would receive 240 000 second tranche NZU’s. This allocation would enable a forest owner to make a decision in the interests of best long term land use and best environmental outcomes and “retire” 300 hectares of at risk land without any financial penalty. The second tranche allocation would thereby incentivise sound land use decision making on an albeit small but material proportion of his plantation estate. Removal of the second tranche will have the opposite effect and sensitive lands will be replanted simply because it is too expensive not to replant.

7. Options for Changing the Second Tranche of pre-1990 Forest Allocation

The independent review panel clearly recognised the fact that offsetting would only be an option for diminishing the impact of the deforestation liability in a relatively limited number of cases. This explains why their recommendation to government was that government should consider clawing back the second tranche of compensation units but only from those who had undertaken offsetting. The FOA does not accept that offsetting removes the need for compensation because the permanent liability remains with the new land, but this option at least allows the forest owners to make an informed choice before proceeding.

The government has included this as one of the options in the consultation document, but has clearly sought to influence the outcome by also including the words that this option “does not recognise the original reason for the compensation”. The FOA completely refutes this comment. The compensation (5% of the expected cost of deforestation) was provided in recognition of the loss of land value. As explained above, there are many reasons why offsetting may not be applicable but this does not mean there has been no loss of land value by pre-1990 forest owners who do not undertake offsetting. Further (as discussed earlier), those who do opt to undertake off-setting also continue to face a loss of land value – being that of the land on which the new forest is planted.

The second option is clearly intended to portray a compromise between options 1 and 3. The FOA does not accept there is any justification for reducing the number of units. It is also a significant concern that this option introduces the possibility that government would even consider a straight unit reduction across all forest owners instead of a pro-rata reduction. We cannot see any justification for such an approach and consider that this would compound the inequities that already exist.

8. Other Forestry Sector Considerations

As the document provides no further detail on what “operational changes to the forestry settings of the ETS” are under consideration, we are unable to come to any position at this stage. The FOA has previously provided detailed comment on:

- the desirability of including an option for uptaking the long term average level of carbon credits. In some form or other we consider this would be attractive to developers of small scale forest blocks;
- allowing owners of forest blocks less than 100 ha the option of undertaking field measurement of carbon at their cost where they consider this will show an appreciably higher level than simple look up tables;
- the need for the ETS to make it clear who has the liability for enforced deforestation where RMA rules prevent replanting via setback requirements.

9. Further consultation

The Association asks to be involved in further discussion or elaboration should that be deemed desirable.

Yours faithfully



David Rhodes
Chief Executive