



Joint Briefing: Specifying Higher Unit Allocation for Forestry in Legislation

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Security Level:		Number of Attachments:	Nil
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Action Sought

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Minister for Climate Change Issues Hon Dr Nick Smith	Direct officials to prepare legislative amendments to specify a unit allocation for owners of forest land purchased prior to 1 November 2002	10am 15 September 2009
Minister of Agriculture and Forestry Hon David Carter	Direct officials to prepare legislative amendments to specify a unit allocation for owners of forest land purchased prior to 1 November 2002	10am 15 September 2009

Contact for Telephone Discussion (if required)

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Executive Summary

You have requested a briefing outlining the implications of specifying an absolute value of 60 NZUs per hectare to allocate to those owners of pre-1990 forest land who purchased that land prior to 1 November 2002.

The Current Legislation

Forestry allocation under the existing legislation operates within a fixed cap of 55 million units from which each eligible person is to be allocated units per hectare, depending on ownership rules and eligibility criteria, namely:

- **18 units** (for Crown Forest Licence land not yet settled on 1 January 2008);
- **39 units** (for land transferred on or after 1 November 2002); and
- **a higher unit allocation** based on a formula to determine this figure for everyone else.

Section 71 states that the total cap of 55 million units is to be reduced by the number of units the Minister estimates is required to cover deforestation activity under the exemptions. Since significant uncertainty surrounds the number of units applied for under an allocation or exemption, if fiscal certainty is desired, it is necessary to put a cap on the units distributed.

Officials have previously estimated that once emissions liabilities from deforestation on exempt land (approximately 10.7 million units) has been accounted for, approximately 60 units per hectare would be available to those eligible for the higher unit allocation. In estimating this figure, a number of assumptions had to be made given uncertainty in both data and the number of applicants applying for allocations/exemptions.

Implications of specifying the higher unit allocation in the legislation

Specifying the higher unit allocation in the legislation effectively removes the 55 million unit cap and increases the fiscal risk to the Crown. The fiscal cost will increase where previous estimates for deforestation rates and the area of pre-1990 forest land have been underestimated. On the other hand, where previous deforestation rates on exempt land and the area of pre-1990 forest land have been over-estimated, the Crown will realise a fiscal saving. That said there are substantial benefits to fixing the higher unit allocation in the legislation, those being:

- it will reduce the potential for legal challenge of the methodology used to estimate deductions for deforestation on exempt land from the allocation pool and from applicants challenging the number of units allocated to others (thereby reducing the amount they are entitled to). There is a high risk of legal challenge in both of these areas;
- it would result in a much simpler system required to process allocation applications as this process is no longer linked to the exemption process and estimating deforestation emissions. Processing timeframes would be reduced significantly and result in more timely unit issue into holding accounts; and
- providing greater certainty to this category of forest landowner who, under the existing legislation, will not know what their allocation will be until the Determinations process is complete.

Rather than specify 60 units in the legislation, a lower number could be used that would reduce the fiscal risk. Should you wish to specify a higher unit value in the legislation an amendment is required. Officials could undertake further work to better refine previous estimates and the fiscal risk if required.

Treasury have noted that this possible policy change has arisen late in the policy development process. Noting the fiscal risks involved, they have indicated that they would be more comfortable if this issue were analysed in a more timely manner. If Ministers wished to make changes in this area, these could be accommodated at a later stage in the parliamentary process.

Recommended Action

We recommend that you:

- a) **Note** that specifying a higher unit allocation in legislation is essentially a trade off between securing greater certainty for eligible landowners (and hence decreasing stakeholder management issues and litigation risk) versus potential increased fiscal risk to the Crown.
- b) **Note** that specifying a unit allocation of 60 in the legislation means it may not possible to contain the cost of the allocation package within the cap of 55 million units.
- c) **Note** that it is possible to reduce the likelihood of increasing fiscal costs through a range of ways including specifying a lower figure in the legislation.
- d) **Indicate** your preferred approach for dealing with specifying a higher unit allocation, being **EITHER** to:
 - i.) leave the legislation as is and not specify a higher unit allocation; OR
YES/NO
 - ii.) leave the legislation as is but direct officials to do further work to more accurately estimate liabilities from deforestation on exempt land and introduce any change to specify a higher limit via the select committee process; OR
YES/NO
 - iii.) draft an amendment now specifying a 60 unit allocation in brackets in the amendment Bill and indicate during the first reading speech that this figure will be finalised once officials have undertaken further work to refine the estimate of deforestation liabilities on exempt land; OR
YES/NO
 - iv.) specify an absolute value of 60 units per hectare for the higher allocation in the amendment Bill
YES/NO
- e) **If your preference is for options d(iii) or d(iv) above, direct** officials to prepare legislative amendments to:
 - i.) draft an amendment now specifying a 60 unit allocation in brackets in the event this figure needs to be decreased; OR
YES/NO
 - ii.) draft an amendment specifying an absolute value of 60 units per hectare for the higher allocation; AND
YES/NO
 - iii.) remove the formula to calculate the upper allocation and requirement to deduct exemptions from the 55 million cap and any other consequential amendments;
YES/NO

APPROVED FOR RELEASE

- f) **Note** that if you want this amendment to be included to LEG on 17th September, a decision is required by 10 am Wednesday 16th September.

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Hon Dr Nick Smith

Minister for Climate Change Issues

Hon David Carter

Minister of Agriculture and Forestry

Purpose of Report

1. This briefing outlines the implications of specifying an absolute value of 60 NZUs per hectare to allocate to owners of pre-1990 forest land who purchased that land prior to 1 November 2002.

Background

The Current Legislation

2. The Climate Change Response Act 2002 (the Act) fixes the total number of units that each eligible person will be allocated per ha, depending on ownership rules and eligibility criteria, specifying:
 - **18 units** (for Crown Forest Licence land not yet settled on 1 January 2008);
 - **39 units** (for land transferred on or after 1 November 2002); and
 - **a higher unit allocation** based on a formula to determine this figure for everyone else.
3. Section 71 also states that the total cap of 55 million units is to be reduced by the number of units the Minister estimates is required to cover deforestation activity under the exemptions. A cap of 55 million units for forestry allocation and exemptions provides greater certainty of the costs to the Crown of the pre-1990 forestry regime in the ETS. This is especially important given the significant uncertainty in the actual number of applications that will be received for either an allocation or exemption. Allowing flexibility in the number of units distributed under the 'higher unit allocation' is the mechanism used to manage this fiscal risk.
4. Previously, officials have estimated that approximately 60 units will be distributed to those eligible for the higher unit allocation, after units for deforestation liabilities from exempt land (total of 10.7 million units¹) have been deducted. In estimating this figure, a number of assumptions had to be made given uncertainty in both data and the number of applicants applying for allocations/exemptions, including:
 - that 1.2 million ha of pre-1990 forestland is eligible to apply for either an allocation or exemption.
 - 100% of eligible landowners apply for an allocation.
 - for the <50ha exemption that some 3000 pre-1990 forest landowners would apply for and obtain exemptions; that those landowners would deforest 20% of the land covered by those exemptions; that the average carbon stocks on the deforested land would be 866 tCO₂-e /ha; and that the average land holding per exempted forest landowner is 18 ha.
 - That deforestation under the 2 ha exemption will result in approximately 100,000 tCO₂-e² per year, in CP1 and in later years.

¹ For the <50ha exemption, this was previously estimated at 9.4 million units over the period 1 January 2008 – 31 December 2021 (3.5 million over CP1) but may be lower due to more accurate carbon stock assessments for deforestation. For the 2ha or less exemption this was previously estimated at 1.3 million units over the period 1 January 2008 – 31 December 2021 (0.5 million over CP1) but may be lower due to more accurate carbon stock assessments for deforestation.)

² This is based on that approximately 20% of pre-1990 forest land is at risk of deforestation in CP1; that approximately 1000 landowners will not be eligible for the <50ha exemption and therefore may wish to take advantage of the 2ha provision; and that some 300 landowners would deforest 2ha (approximately 500,000 tCO₂-e) in CP1. On average this amounts to 100,000 tCO₂-e² per year, in CP1 and in later years.

5. As there is significant uncertainty in the data used and assumptions made to feed into estimates of the 'higher unit allocation', officials have been careful to state this is an approximate figure only and that depending on revised estimates of deforestation rates under these exemptions (particularly the <50ha exemption), this figure could be higher or lower.
6. It should be noted that this estimate did not include units held back to cover deforestation liabilities under the tree weed exemption. This figure has recently been estimated at 2.3 million units for the period 1 January 2008 – 31 December 2021 (~ 1 million units for CP1).
7. Reductions to the forestry allocation need to be made on the basis of a defensible methodology to estimate deforestation liabilities for exempt land, and therefore it was always intended to more accurately estimate likely deforestation rates. MAF officials will be commissioning independent advice on the best methodology to undertake this work. From a timing perspective, determining more accurate estimates of emissions from deforestation of exempt land can best be made once all of the applications for exemptions are received and assessed (likely to be the latter half of 2010).

Analysis

Implications of specifying a higher unit allocation in the legislation

Fiscal costs of specifying 60 units

8. The original working estimates did not include emissions from the deforestation of tree weeds, therefore including deforestation emissions from this exemption would reduce the number of units available for the higher unit allocation. However this is countered by refined estimates of carbon stocks³ applied to deforestation. Initial calculations suggest these two aspects offset each other, therefore specifying 60 units would impose a negligible impact on the fiscal cost relative to the current situation.

Fiscal Risks

9. Where the higher unit allocation is specified in the legislation, there are two key factors that will impact on whether the fiscal risk will increase or decrease, they are.
 - if more accurate estimates of deforestation on exempt land vary from previous estimates of 20% (10.7 million units); and
 - whether the area of pre-1990 forest land varies from the 1.2 million hectares⁴ area previously used.
10. Where deforestation rates are found to be greater than 20% and the area of pre-1990 forestland applied for is greater than 1.2 million hectares then the fiscal risk of exceeding the 55 million cap increases significantly. Conversely, where emissions from actual deforestation are less than previous estimates and the land applied for is less than 1.2 million hectares, the fiscal cost could decrease by an equivalent amount. This impact will only be known with any certainty at the end of CP1. Therefore

³ These numbers have been refined on the basis of more accurate research undertaken by Scion since the initial estimates were done.

⁴ Data from LUCAS recently suggested the area may be around 1.4 million hectares, however work subsequently undertaken by MAF and MfE suggest it is closer to 1.2 million, but it is not possible to give a definite figure at this time.

specifying an absolute number of units to be allocated in the legislation **before** this will increase the fiscal risk, perhaps substantially⁵.

11. However fixing the higher unit allocation introduces significant fiscal risk. There is a risk that the cost of the allocation may be much greater or much less than the 55 million units that it is currently capped at. This is because where emissions from actual deforestation within exempted areas exceeds previous estimates, the fiscal cost increases substantially.
12. Table 1 outlines the fiscal impact of a 1% change in deforestation emissions under the <50ha exemption relative to the current assumption of 20%. If deforestation is above 20% this would lead to a fiscal cost, if less, then a fiscal saving.

Table 1: Fiscal Impact of 1% change in rate of deforestation of <50 ha exempt forestland

NZ Units	Cost (\$25/tonne)
390,000	\$9.7 million

13. In addition, where the higher unit allocation is set in the legislation, fiscal savings could be realised if less than 100% of those eligible for an allocation apply. Table 2 below shows the savings for each 1% of eligible forest landowners (excluding CFL⁶ land) who do not apply for an allocation.

Table 2: Fiscal savings from a 1% reduction in application for an allocation

NZ Units	Cost (\$25/tonne)
350,000	\$8.9 million

Benefits of specifying the higher allocation value in legislation

14. Specifying a figure for the higher unit allocation does have several benefits for reducing the likelihood of legal challenge, managing administrative processes and stakeholder expectations.
15. The key benefit of specifying the higher unit allocation in legislation is that it will significantly reduce the potential for legal challenge in two areas. The first is of the methodology used to estimate deductions for deforestation of exempt land from the allocation pool. The second is legal challenge from applicants where they maintain units have been over-allocated to other applicants, thereby reducing the amount they are entitled to. Both of these areas have been assessed as likely to result in legal action.
16. Specifying the unit value would result in a much simpler system required to process allocation applications. This is because allocation of the higher units is no longer linked to the exemption process and estimating deforestation emissions. Processing timeframes would be reduced significantly and result in more timely unit issue into holding accounts.
17. Specifying the higher unit allocation would also provide greater certainty to this category of forest landowner who, under the existing legislation, will not know what their allocation will be until the Determinations process is complete. However, if

⁵ Although there would be no need to estimate emissions from deforestation on exempt land to calculate the higher unit allocation, it would still be necessary to quantify in order to determine the extent of the Crown liability and to aid Treasury forecasting.

⁶ CFL land is excluded as it is assumed an allocation for all of this land will be sought.

foresters believed that they would receive fewer units under the new allocation scheme, they may resist these changes.

Impact on ability to manage eligible Maori owned land where owner is unknown or cannot be located

18. An issue has arisen about the treatment of small blocks of Maori land where the owner is unknown or unable to be traced. If owners of land cannot be contacted or identified within the timeframe of the current Forestry Allocation Plan they will miss out on an exemption or allocation, which could be seen as inequitable. Amending the legislation to allow some units to be set aside would address this. Fixing the upper limit in legislation and removing the 55 million cap would make it easier to accept late applications, albeit at a financial cost to the Crown. The Ministry of Agriculture and Forestry is working with the Maori Land Court, and Te Puni Kokiri to better quantify the issue and identify potential solutions.

Options to manage the fiscal risk/cost

19. Should you wish to limit the fiscal costs and risks associated with fixing the higher amount of units to be allocated in legislation, there are a number of options available to you. On initial consideration, officials have identified two alternative options to manage and/or contain the fiscal risk of specifying the higher unit allocation in legislation, The options identified are:

Option A – limit exemption size

20. Limiting the size of exemptions by reducing the eligible area e.g., to 40ha. This would reduce the number of eligible landholdings by approximately 12.5% and result in a small fiscal saving of around \$14 million. However this would likely be unpopular with a reasonable number of forest landowners. This will also increase the number of small players participating in the ETS, which would increase the compliance and administration costs.

Option B – set lower figure than 60 in legislation

21. A more conservative figure for the higher level allocation could be specified in the legislation. This would have the multiple benefits of providing certainty for forest landowners, minimising litigation risk, managing administrative processes and managing fiscal risk to an extent.
22. Further work is needed to fully analyse the impact of the options identified, and consider whether there are other options available. An alternative would be to specify a 60 unit higher allocation in the amendment Bill but indicate during the first reading speech that this figure will be finalised once officials have undertaken further work to refine the estimate of deforestation liabilities on exempt land.
23. Table 3 below outlines how a reduced maximum unit/hectare allocation covers an increased deforestation margin on exempt land. At an allocation of 55 units per hectare a deforestation rate of 27% (20% + 7%) could occur before the Crown was faced with increased fiscal costs.

Table 3: Safety margin from reducing the allocation

Specified Highest Unit Allocation in CCRA	NZ units	Safety Margin (in terms of extra percentage of deforestation that could be covered)
55 units	2,742,025	7.0%
58 units	1,515,703	3.9%

Conclusion

Specifying a figure for the higher unit allocation in the legislation would be simpler to administer, reduce litigation risk and would provide more certainty to stakeholders but may result in an increased fiscal cost to the Crown. The fiscal risk of doing this is difficult to predict. The risk could be minimised by setting a reduced level of allocation of around 55 units per hectare, or lower.

Consultation on this Paper

This paper was reviewed by the Ministry of Agriculture and Forestry, Ministry for the Environment, and Treasury. Treasury noted that there was little time for officials undertake more indepth analysis of the impact of the proposal. They also noted that specifying an absolute figure in the legislation results in increased fiscal risks for the Crown and favours keeping within the current capped approach. In reference to Treasury’s comment, an alternative approach could be to undertake further analysis and introduce an amendment specifying a higher allocation during the select committee.