



Submission on the New Zealand Emissions Trading Scheme Review
2015/16

Forestry Technical Note

New Zealand Forest Owners Association Inc

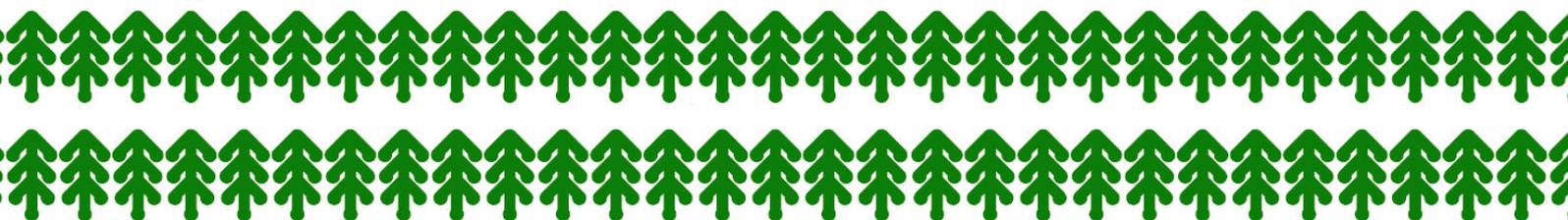
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Introduction

This submission has been prepared by the NZ Forest Owners Association (FOA), on behalf of our members.

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 1.2 million ha of rural land, 80% of which is in plantation trees. The total New Zealand plantation forest area is 1.7 million hectares.

In March 2016 the government sought feedback on a number of matters specifically related to the treatment of forestry under the Emissions Trading Scheme (ETS). This was in addition to an Operational Matters Technical Note and the November 2015 Discussion Document. This submission should be read in conjunction with the other submissions made by FOA on those papers.

The Forestry Technical Paper covers structural design settings for forestry, other forest programmes, the international context and two important potential approaches for recognising forest carbon sequestration viz. Averaging and Harvested Wood Products.

The following submission addresses these topics and some of the questions raised in the technical note.

Summary

The ETS structural settings are not encouraging forestry investment at an optimal level for society. It is acknowledged that there is scope to adjust these settings and the FOA supports some of the options that have been listed in the Technical Note.

Both averaging and deferred liability of harvested wood products emissions could have a significant impact on the attractiveness of carbon forestry by reducing the amount of carbon liability to be repaid upon harvest and reducing perceived risk. Of these two we consider that the emphasis should be on devolving Harvested Wood Products liability as this may negate the need to also introduce averaging.

The document notes there is scope to look beyond the rigidity of the UNFCCC agreed methodologies. Potentially this includes removing the artificial distinction line of 1990 that currently divides forests and we believe there is merit in MPI considering the implications of this. At the least there should be recognition of any contribution made to emissions reduction by pre-1990 forests that already satisfies existing international agreements.

2.0 Existing Structural Design Settings

The forest growing sector was the first section of the economy to be brought in to the Emissions Trading Scheme. As one of the least cost abatement options for New Zealand, the ETS should have provided a signal that recognised this and sought to encourage

further forestry development. It has not done that, largely because one of the key objectives of the ETS has been ignored – that of bringing about change in behaviour to usher in a low carbon-dependent economy. Instead, the ETS has been measured against the single objective of least cost-abatement today.

As a consequence there has been:

- A reliance on offshore units regardless of their pedigree;
- Minimal behavioural change by emitters;
- Net deforestation in New Zealand.

The current settings combined with forestry's experience with the ETS since its inception, mean that there is minimal encouragement of afforestation or reforestation. The ETS is shunned by many owners of smaller, limited age class forestry blocks. The single biggest reason why more post-1989 forest owners are not registered in the ETS is because of the uncertainty over carbon price at harvest.

The ETS settings not only fail to discourage deforestation, they actually promote it. Providing sufficient incentive to re-forest should be the focus rather than considering that more might be done to prevent deforestation.

One strength that the ETS does have that should be retained is allowing growers the flexibility to choose whether they participate or not as it suits their circumstances and abilities. Not everyone wants their land use choices to be encumbered by ETS requirements. Equally, some forest owners will wish to participate with full credit and full liability and this should be taken in to account when considering alternative approaches like averaging.

3.3 Future forestry accounting in the NZ ETS

As acknowledged in the Technical Note we do have a choice about the extent to which we align the NZ ETS settings with international methodology and there are compelling reasons why adjustments should be made to the settings for forestry in particular.

The Forestry Technical Note also records that "much of the (forest) sector's design settings were based on Kyoto Protocol first commitment rules" and notably the Kyoto base year of 1990.

As spelt out in the document this has created quite a distinction in how forests pre and post-1990 are dealt with. This line in the sand has created a potentially beneficial opportunity for some, but not for others. It is also a permanent divide. Theoretically, in future generations, forests that are indistinguishable on the ground could be dealt with very differently through the ETS.

The atmosphere, of course, makes no such distinction between either of these types of forest when it comes to the carbon absorbed. In New Zealand we could also decide that we will treat all forests the same, and reward and encourage all forestry. The most practical way to do this would be to treat any pre-1990 forest that is being replanted as afforestation and allow the same voluntary option to enter the ETS as for post-1989.

This obviously has implications for supply and demand of units and consequently price. It also departs from the internationally agreed definition of additionality i.e. only afforestation is considered to be new, and additional, sequestration. At the international level New Zealand would still be obliged to account for this liability, but it would provide a positive reinforcement of the value of replanting. Land use change would still trigger deforestation liabilities.

Such a change may be considered to be beyond the scope of the Review but recognising carbon sequestration by pre-1990 forests that does meet the international definition of additionality should be introduced as part of the Review.

In a number of forests that were first established some time pre-1990 the carbon reservoir that exists at maturity today is significantly larger than what was contained at maturity in previous rotations and, furthermore, will be less than the carbon stored in future forests at maturity. This may be a consequence of a number of factors including species change, greater volume, greater density, faster growth or higher stocking rates. In many cases such changes are well recorded and the carbon associated is easy to calculate. This will not apply to all pre-1990 forests, but where it is the case we consider it is appropriate for New Zealand to record this additional sequestration in the national accounts for the country's benefit, and also for the pre-1990 forest owner to have the option of claiming the credit (and associated liability if not maintained).

Averaging

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 sufficient credits to cover this (effectively self-averaging), many ETS-eligible forest-owners are unlikely to be interested in taking on this task and thus harvest liability remains a significant obstacle to participation.

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 and has long been supported as a voluntary addition by the FOA.

Removal of the threat of an unknown cost at harvest is likely to encourage a higher level of 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 FOA is not, however, in favour of this being brought in as a compulsory option for all forest owners. Although it could, and should, be made optional for all forest owners, it would not suit many owners of large multi-age forests and the current option (non-averaging) 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.

Any change of land-use would, of course, trigger deforestation liabilities as normal. Such a covenant can be registered against the title and any future buyer would be well aware they were effectively buying pre-1990 type land, but with no hand-back obligations as long as land stays in vegetation.

The only reason not to introduce this option to the Emissions Trading Scheme would be if deferred liability of the carbon in wood products was devolved to forest growers as proposed by the industry below.

Deferral of harvested liability achieves a similar outcome in that it removes the concern associated with a large one-off liability in the year of harvest. If deferred liability was introduced we consider that it would then be worth consulting further with the industry to determine if there was still any appetite for introducing averaging. We anticipate the demand would be minimal, and not justify the time and effort to implement it.

Harvested Wood Products

The FOA has participated in previous NZ government delegations to bring about change from the instant oxidisation approach. We were successful in this at the Durban climate change negotiations in 2011. The important change agreed means that New Zealand can, and will, report and account for the carbon stored in wood products and consequently benefit from deferring the emission from forest products. Reporting commenced last year and the benefit of deferring the liability will be made use of by New Zealand in its 2021-30 emissions target.

At the domestic level, however, New Zealand policy still reflects the previous incorrect assumption that all harvested carbon is emitted at the time of harvest i.e. the ETS excludes any recognition that most of the carbon continues to be held in wood products long after the forest has been harvested.

The Forestry Technical Note acknowledges that there are options to recognise the deferred emissions liability both within the ETS and also outside the ETS. The Wood Council of New Zealand, which represents growing, processing and manufacturing interests, has given consideration to how this might be achieved. While detail remains to be determined there is a common interest in pursuing both of the avenues, inside and outside of the ETS, which the Technical Note refers to.

Accordingly, and consistent with the Forestry Technical Note:

1. It is proposed that deferred credits together with their associated liabilities should be devolved to the post-1989 forest growing sector via the ETS as suggested in the Forestry Technical Note.
2. It is also proposed that financial support based on unutilised carbon credits outside of the ETS should be targeted directly at wood processing without creating significant compliance costs.

Some key elements of this two-fold approach are that:

- a. Only the average decay curve for harvested wood products should be applied in the ETS;
- b. Direct application of the deferred harvest liability for post-1989 forests in the ETS to the processing sector, or a point of obligation further down the value chain, is not supported;
- c. Direct application of the deferred HWP liability to the forest growing sector would be positive for investment, could be done relatively easily and would satisfy most, if not all, of the criteria. How this benefit might be distributed across the rest of the value chain is not easily quantified.

Devolvement of liability for participating post-1989 forest owners:

Forest owners who participate in the ETS currently still face an instant requirement to account for all of the carbon emissions associated with the log at harvest.

The FOA considers that this needs to change and that benefit of HWP deferred liability should be devolved to the sector. The independent review panel arrived at the same view and recommended that: "The ETS rules in relation to post-1989 harvested wood products (HWP) should be modified to reflect an "emissions to atmosphere" approach if this has been agreed internationally".

As well as addressing the single biggest obstacle to participation in the ETS by forest growers it would also free up 'banked credits' that forest owners are holding for surrender upon harvest thus providing additional liquidity and stability to the carbon market.

It is proposed that the emissions liability for carbon stored in harvested wood products should be devolved to post-1989 ETS-participating forest growers on harvest on a per hectare basis, rather than treated as an instantaneous emission, and then 'oxidised' from the growers' ETS accounts according to the average decay curve for HWP. This would not require the growers to adopt HWP accounting, as the liability could be debited from the ETS accounts automatically by MPI on an annual basis using a simple computer algorithm. The direct debit would be modified by the government from time to time as the national product mix changed. This would add no compliance costs to the growers and would be cheap to run once established.

The average decay curve would be determined from the product mix and half-lives used by the government for reporting its international obligations.

This approach would substantially reduce ETS-registered forest owners' anxieties about carbon liabilities at harvest time. It would facilitate the following desirable outcomes:

- More forest planting on under-utilised and vulnerable land;
- Improved returns and a greater volume of wood products that would displace less benign competing products;
- A reduction in the risk of catastrophic forest loss from climate change through encouraging growers to harvest and replant, rather than holding forests past maturity;
- Remove the current perverse incentive not to harvest, thus generating more employment for both harvesting and silvicultural contractors.

The proposed change is simple, inexpensive and has positive implications that would help deliver on the basic purposes of the ETS, notably:

- a. For a post-1989 forest grower in the ETS who had claimed all of the credits available as the forest grew, the surrender liability on harvest would be reduced to a fraction of what is currently required and the balance of the liability spread in a more manageable way;
- b. Forest owners would have a wider 'price window' (of log prices vs carbon prices) in which it was profitable to harvest;
- c. The IRR (Internal Rate of Return) of a first rotation forest would increase; investors would be encouraged to plant new forests and retain existing post-1989 forests;
- d. Wood processors would have a more assured log supply as forests were planted, cut and replanted and it would ensure wood processors were not confronted by oversize logs;
- e. The risk of carbon loss through catastrophic storm events would be reduced as on average, forests would be harvested more frequently;
- f. The allocation would be de-coupled from product mix and market destinations. Consequently there would be no effect on log prices since the proposed change would not involve HWP accounting;
- g. There would be no market distortion affecting wood processors. Domestic production, export production and wood product imports would all be treated equally without the need to account for carbon storage;
- h. Introduction of deferred liability would have some implications for the concept of averaging for which feedback is also sought in the Forestry Technical Note. The industry has previously argued for the optional inclusion of averaging carbon sequestration over time. For owners of smaller blocks of limited age classes of tree this was seen as particularly beneficial. If deferred liability were applied as proposed above, this

would significantly reduce the need for averaging as it would remove most of the sudden and large liability associated with harvest.

The change would not:

- a. Affect a post-1989 forest grower's liability on deforestation. At that time all carbon liabilities in the grower's ETS account would fall due as they do now;
- b. Affect the government's own HWP accounting practice or its reporting to the UNFCCC;
- c. Lead to any additional compliance costs for the industry;
- d. Appear to have any fiscal implications for the Government, other than through the lag effect of growers deferring the surrender of NZUs /ha at harvest.

By default the government assumes all credit and associated liability for gains and losses in the carbon pool. The industry recognises therefore that it is important to manage the Crown liability with any proposed revisions within the ETS. Devolvement of the deferred liability for harvested wood products to participating forest growers satisfies this criterion and is simply an extension of existing credits and liabilities.

This dual approach for dealing with harvested wood products is elaborated on further in the Wood Council submission which should be read in conjunction with this submission.

FOA requests the opportunity to be heard in support of our submission.



David Rhodes
Chief Executive