

5 May 2004

The Chair
Cabinet Policy Committee

PROPOSED MECHANISM TO FACILITATE PERMANENT (NON-HARVEST) "COMMERCIAL" FOREST SINKS

Purpose

1. On 7 May 2003 the Cabinet Policy Committee (POL) "**directed** officials to refer the proposed mechanism [to facilitate permanent (non-harvest) forest sinks] to private sector interests and invite comments on it, and report the outcome of this process to the Convenor, Ministerial Group on Climate Change and the Minister of Forestry".
2. POL authorised the Convenor and the Minister to finalise the details of the mechanism provided these are not substantially different to those agreed by the Committee [POL Min (03) 10/6]. This paper recommends a substantial change to the mechanism and accordingly seeks POL's agreement to that change.

The Proposed Mechanism

3. The proposed mechanism as agreed by POL would be contracts between the Crown and landowners that are registered against land titles. Under these contracts the Crown would agree to provide an amount of tradable carbon emission units equal to the amount of carbon sequestered by new forests on a given block of land over the first commitment period of the Kyoto Protocol (CP1, 2008 - 2012). Landowners would also be assured of access to credits post 2012 to the extent that the future rules of the Kyoto Protocol allow for this. In return, landowners would contract with the Crown not to harvest trees from the newly established forests. Deliberate breaches of these non-harvest covenants would attract penalty payments to the Crown.
4. Landowners would have to agree to reimburse the Crown if the amount of carbon on their land declined and this resulted in a consequential liability to the Crown under the Protocol. Landowners would also be liable for ongoing monitoring, verification and administrative costs.
5. Obligations under these contracts would be registered against land titles and would run with and bind the land. They would be perpetual, unless either:
 - The Crown agreed to vary the contract with the landowner; or

- Future rules of the Kyoto Protocol no longer allowed for credits to be earned from the forest (in which case only liabilities for losses in carbon would continue to apply to landowners, to the extent they continued to apply to the Crown).
6. The mechanism is essentially commercial in nature, allowing landowners to make better economic use of their land, particularly isolated and erodable areas. Though not specifically designed to generate environmental benefits other than carbon sequestration, the mechanism would result in positive environmental outcomes in terms of biodiversity, soil and water conservation, and reducing agricultural emissions through displacing pastoral agriculture.
 7. The mechanism will require legislative backing, particularly in relation to the registration of contracts against land titles and the enforcement and penalty regime, and will be administered by MAF. Accordingly, the Climate Change Response Amendment Bill will include provisions to extend the regulation making powers of the Forests Act 1949. Regulations would then be made to give effect to the mechanism.

Issues Arising from Consultation

8. The principal issues raised in submissions and at a meeting of officials and interested parties focused on three areas:
 - It is unreasonable to expect landowners to carry all the uncertainties and associated risks and potential liabilities from a mechanism designed to operate in perpetuity, when the government cannot provide all the rules beyond 2012;
 - The costs of entering the mechanism have been underestimated, are likely to be high, and may not be covered by the benefits if the value of carbon is low; and
 - Uptake of the mechanism will be low without some ability to harvest and earn revenue to cover ongoing management costs once credits cease being earned.

Recommended Changes to the Proposed Mechanism

9. In response to this feedback one significant change to the mechanism is recommended. This is to allow for a limited timber harvest under continuous canopy management after a minimum non-harvest period of 40 years.
10. Less substantial changes and refinements of agreed policies include:
 - Landowners not being required to pay back credits "issued in error" if clarification of the international rules, or changes in interpretations of international rules, mean that forests previously assumed to qualify for credits no longer do so;
 - Consortia of landowners may operate under an agreed joint management plan;
 - Boundaries of forest sinks can be identified on diagrams and maps for registration against the land title (rather than formally surveyed); and
 - 'Insurance' to cover potential liabilities will allow consortium and set aside options for landowners.

Limited Timber Harvest

11. The key issue is the rate of uptake of the proposed mechanism. The landowner / forestry groups consulted have presented a strong message that uptake will be minimal without a

long-term harvesting option, i.e. once credits cease being earned, to offset ongoing management costs and to avoid liabilities from senescent stands that lose volume and become unthrifty.

12. Once a stand reaches maturity, there is no net sequestration of carbon and consequently no credits will be produced to cover ongoing management costs. Also, forest stands tend to reach high standing volumes at maturity then suffer some degree of "collapse". (This is usually not so pronounced in more diverse indigenous forests). This could result in significant carbon liabilities for the landowners.
13. Allowing some level of harvesting once credits effectively cease to be earned would provide a source of income to offset ongoing monitoring and management costs, and may enable the health of unthrifty forests to be improved.
14. A limited harvesting option would reduce the potential for stand "collapse". It would also reduce the risk of densely stocked, unmanaged stands, which tend to be prone to fire, disease and windthrow. It may provide a significant boost to the establishment of some special purpose and indigenous timber species for production, as these would be ideally suited to the long rotation, low level harvest regimes that would apply under a limited harvest option as outlined in paragraph 17.
15. Earlier feedback from Māori also suggested that some level of sustainable harvesting should be allowed under the mechanism as a way of addressing inter-generational equity between the current landowners who will receive sink credits, and future generations of landowners who will not receive credits.
16. A principal argument against including a harvesting option is maintaining a clear "boundary" between permanent forest sinks and commercial forestry operations. The boundary issue could be addressed relatively easily by establishing a minimum time period before harvesting was allowed and restricting the nature of harvesting to exclude clearfelling, such that business-as-usual commercial forestry operations are excluded by economic imperatives. An appropriate minimum time period before any harvesting is allowed might be 40 years.
17. We therefore recommend that after 40 years forest sink owners are able to introduce restricted harvesting through continuous canopy forest management. (This is where canopy trees are progressively thinned to promote advanced regeneration and retention of the forest structure). It is not recommended limiting the volume of timber that could be removed over any time period. The restraints would be the requirement to retain the forest structure and that losses in sequestered carbon would incur carbon liabilities.

Fiscal Implications

18. There are no new fiscal implications arising from this paper.

Legislative Implications

19. There are no new legislative implications arising from this paper.

Publicity

20. It is proposed that any agreed changes to the mechanism be announced as part of the announcement of the Forest Industry Framework Agreement package of measures. This will most likely be made by Ministers to a special meeting of the Steering Group of the Wood Processing Strategy.

Consultation

21. The following departments have been consulted during the preparation of this paper: Treasury, Te Puni Kokiri, Department of Prime Minister and Cabinet, New Zealand Climate Change Office, Department of Conservation, Land Information New Zealand.

Recommendations

22. It is recommended that the Cabinet Policy Committee:
1. **note** that on 7 May 2003 the Cabinet Policy Committee (POL) agreed on the structure of a mechanism to facilitate permanent (non-harvest) forest sinks, but directed officials to consult with private sector interests and report their comments back to the Convenor, Ministerial Group on Climate Change and the Minister of Forestry [POL Min (03) 10/6 refers];
 2. **note** that POL authorised the Convenor, Ministerial Group on Climate Change and the Minister of Forestry to finalise details of the mechanism, provided these are not substantially different to those agreed by the Committee;
 3. **note** that, in addition to a number of minor refinements and clarifications to the mechanism, one significant change is proposed to allow some limited harvesting of forests established under the mechanism; and
 4. **agree** that the mechanism to facilitate permanent (non-harvest) forest sinks allow for a limited timber harvest under continuous canopy management after a minimum non-harvest period of 40 years.

Hon Pete Hodgson
Convenor, Ministerial Group on Climate Change

Hon Jim Sutton
Minister of Forestry

References: POL (04) 83 & POL (04) 9/7