



# Permanent Forest Sink Initiative

## Proposed Changes to Unit Type and First Stage of a Review of the Operation of the Scheme

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## Summary

The Government is seeking your feedback on two separate matters:

- options for the issuance of units for 2013 and future years;
- ways of improving the operation of the Permanent Forest Sink Initiative.

The Government is committed to improving the scheme and enhancing its value for the future. Key areas for consideration are alignment of business processes with the Emissions Trading Scheme, recognition of co-benefits, and recognition of the added value of the PFSI.

## WHY ARE WE CONSULTING YOU?

- Decisions made at Doha negotiations in 2012 mean that the Government can no longer guarantee to issue Assigned Amount Units to participants in the Permanent Forest Sink Initiative beyond 2015.
- This has triggered a termination clause in the covenants used in the initiative.
- The Government wants to continue with the scheme, but wishes to consult on options for the issuance of units for 2013 and future years.
- The Government is required by law to consult all participants before changing the type of unit to be allocated.
- The Government also wants to make improvements to the scheme for its future.
- You have until 30 June 2013 to decide whether to terminate your covenant, though this deadline can be extended if all parties to the covenant agree.

The closing date for submissions is Wednesday, 5 June 2013.

Submissions or queries should be addressed to:

PFSI Submissions  
Forestry & Land Operations Group  
Ministry for Primary Industries  
P.O.Box 2526  
Wellington 6140

Alternatively responses or queries can be emailed to: [pfsi@mpi.govt.nz](mailto:pfsi@mpi.govt.nz)

Feedback will be considered and the type of unit to be issued is expected to be decided in time for participants to consider before 30 June 2013 whether to terminate or continue in the scheme.

This consultation will also be the first stage of a period of public engagement on improving the operation of the scheme. Workshops and stakeholder meetings will be convened as required to gather perspectives from existing and potential participants in the scheme. Specific proposals will then be developed for public consultation.

## RELEASE OF SUBMISSIONS

All submissions are subject to the Official Information Act 1982. Therefore, if you consider that all or part of your submission is commercially sensitive or should be treated as confidential, please state this clearly when making your submission.

# 1 Introduction

The Permanent Forest Sink Initiative (PFSI) is a greenhouse gas emissions scheme that allows participants to be issued units for net increases in forest carbon in eligible forests. It has been in effect since 2008. The units can be sold to greenhouse gas emitters via emission trading markets. It is governed by Part 3B of the Forests Act 1949 and regulations made under this Act.

The concept was first proposed around 2000, and approved by Cabinet in 2003. The Cabinet paper noted among other things that the mechanism was to clearly separate forests established for timber production from those established for carbon sequestration; and was to maximise overall environmental benefit. It was noted that although not specifically designed to generate environmental benefits the mechanism will result in positive environmental outcomes in terms of biodiversity, soil protection, and water quality.

Around 20 000 hectares have now entered the scheme and approximately 75 percent of this is indigenous forest.

There is a regulatory requirement to review the type of unit to be issued to participants for net increases in forest carbon in 2013 and future years. This requirement exists because the type of units that would be available, and New Zealand's participation in the Protocol after its first commitment period were not known when the scheme began in 2008.

In 2011, the scheme was reviewed along with other government afforestation schemes by an independent Panel. The Panel recommended that the Permanent Forest Sink Initiative should continue, but that *“there is logic in having the two carbon forestry schemes administered under the same legislation and ensuring consistency in common processes, definitions and criteria”*. It also recommended that any change should be deferred until after 2012 when it was expected there would be more clarity around carbon markets and New Zealand's involvement in the Kyoto Protocol.

More clarity has emerged, but issues such as the future for carbon trading, bilateral or multilateral linkages, mutual recognition of units between countries, the use of forestry offset schemes, and the types of units that may be available are likely to continue to evolve. Nevertheless it is an opportune time to consult publicly on the operation of the scheme along with the review of unit type.

## 2 Proposals & Discussion

### 2.1 ISSUE 1 –UNIT TYPE

Two options are proposed:

**Option A** is to issue New Zealand Units for 2013 and future years (Government's preferred option).

**Option B** is to continue issuing Assigned Amount Units while they are available, then switching to New Zealand Units (the hybrid option).

#### 2.1.1 Background

PFSI landowners receive Assigned Amount Units for net increases in forest carbon during the first commitment period (2008-2012). After this, landowners are entitled to receive units of a type approved by the Minister<sup>1</sup>. Prior to making a decision to approve a type of unit, the Minister must consult with the landowners who would be affected by the decision.

The Emissions Trading Scheme was not in place when the PFSI was designed, so the only units that were available were the Kyoto Protocol units that the New Zealand Government had access to i.e. Assigned Amount Units or Removal Units. Removal Units will not be received until 2015, so the only units that could be issued were the Assigned Amount Units.

Up to 2010 a ready offshore market existed for these Assigned Amount Units and some PFSI participants traded their units. It is also possible for ETS participants to convert their New Zealand Units to Assigned Amount Units and export them, and this was also taken up by some ETS participants up to 2010. However, international demand for Assigned Amount Units declined after 2010 due to a global oversupply of Kyoto units.

#### 2.1.2 What unit types are available?

The only units currently available for the Government to issue in 2013 and future years are New Zealand Units or Assigned Amount Units<sup>2</sup>. However, the availability of Assigned Amount Units after 2015 is uncertain. Furthermore, issuing them to the PFSI would disadvantage the Government as it would reduce the credit available to count against its 2020 emissions reduction target.

Until international trading of units resumes under a successor agreement to Kyoto, both unit types could only be used for surrender in the New Zealand Emission Trading Scheme. New Zealand Units have the highest value currently. In effect, these two unit types are interchangeable in the short term.

International demand for these units may return in 2020. Units generated by the PFSI may have a premium in international markets due to the environmental integrity of the scheme. However this may require PFSI units to be differentiated in the market. Ways of achieving this will be investigated as part of the review of the scheme operation.

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<sup>1</sup> Refers to the Minister of Forestry, now delegated to the Associate Minister for Primary Industries.

<sup>2</sup> These are the Assigned Amount Units that would be surplus after meeting the first commitment period accounting obligation.

The table below shows the advantages and disadvantages of these two unit types to participants.

Option	Advantages	Disadvantages
New Zealand Units	<ul style="list-style-type: none"> <li>• Unlimited life</li> <li>• Currently a higher value than Assigned Amount Units</li> <li>• Can be converted to CP1 Assigned Amount Units until 2015 and exported but no international demand</li> <li>• Could be converted to any future type of Kyoto unit and exported if New Zealand regains access to international trading</li> <li>• Potentially traceable to the PFSI scheme through the New Zealand Emission Unit Registry</li> </ul>	<ul style="list-style-type: none"> <li>• NZUs issued to PFSI are not differentiated from units issued to ETS forests or allocation units</li> </ul>
Surplus CP1 Assigned Amount Units	<ul style="list-style-type: none"> <li>• Can be exported directly</li> </ul>	<ul style="list-style-type: none"> <li>• Availability after 2015 uncertain.</li> <li>• Carry over past 2020 unlikely</li> <li>• Currently a lower value than New Zealand Units</li> <li>• Limited demand internationally</li> <li>• Can't be converted to NZUs</li> </ul>

The Government's initial assessment is that **Option A** provides a greater net benefit to participants and the Government than **Option B**, and so is the preferred option.

### QUESTIONS

- Which option do you prefer?
- Do you agree that New Zealand Units should be issued to the PFSI? If not, which units do you think should be issued?
- How important is it that the type of unit issued to the PFSI is able to be exported?
- How important is it that the unit is able to be traced or identified as belonging to the PFSI?

## 2.2 ISSUE 2 – HOW COULD THE PERMANENT FOREST SINK INITIATIVE BE IMPROVED?

The Government wishes to make the PFSI work as well as possible for all parties. We are seeking your views on how the operation of the scheme could be improved.

### 2.2.1 Relationship with the Emissions Trading Scheme

The PFSI is administered under the Forests Act 1949 and was designed before the post-1989 forestry component of the Emissions Trading Scheme.

A proposal for merging the PFSI into the Emissions Trading Scheme was part of the public consultation of the 2011 review. The review panel noted that ideally the PFSI should be a subset of the Emissions Trading Scheme, as they considered that this would make it easier to explain and promote the scheme, and would also minimise administrative costs.

However submitters who were involved in the PFSI through the marketing of Assigned Amount Units, promotion of the scheme or facilitation of landowners to join the scheme, were



strongly of the view that it should run alongside, but be independent of the Emissions Trading Scheme.

In this consultation, the Government is not proposing any change to primary legislation. If the outcome is that amendments to the ETS legislation are needed for the optimal operation of the PFSI in the future, these would not be implemented until the next opportunity arises to amend this legislation.

### 2.2.2 Access and Administration

The PFSI has gaps that were intended to be addressed at a later date when the Emissions Trading Scheme was developed. In 2009, officials were working on options for proposed changes to the PFSI Regulations that would provide the PFSI with the same or similar processes as were developed for the post-1989 forests in the Emissions Trading Scheme. Common processes eliminate duplication of administration and legislation and should be aligned for efficiency and client focus reasons.

Work on this was deferred until the 2011 review of afforestation schemes was undertaken. In the interim, the covenant template was amended several times to cover carbon measurement and 5-yearly emission returns. In its current form, the scheme is cumbersome and complex for users.

Further possible administrative improvements include:

- Simplifying the covenant document, or removing it in favour of contractual agreements between the Crown and the landowner.
- Making the scheme available to secondary legal interests such as forestry rights or leasehold interests.
- Strengthening the permanence aspect of the scheme under the current or future legislation;
- Making the scheme more accessible to Māori land owners.
- Using the same business processes as the ETS, e.g. forms, online applications and mapping.

### 2.2.3 Recognition of co-benefits

It has always been recognised that the PFSI can deliver wider environmental co-benefits. This potential could be strengthened by:

- Further prescription under the management plan to ensure environmental co-benefits are delivered.
- Measurement of ecosystem services provided by the scheme so that they can be valued by future markets.
- Increased promotion and advocacy to target land classes such as erosion prone land and reverting farmland.
- Stronger sustainable forest management prescriptions under the scheme for example:
  - the ability to exclude forest species or forest management regimes not well suited to permanent retirement;
  - the ability to exclude (or limit) the presence of grazing animals in the forest during secondary phase reversion; and
  - increase the measures for pest control.

#### 2.2.4 Recognising the added value of the PFSI

The PFSI requires a commitment from participants to continuous cover forestry for 99 years, and many projects deliver environmental co-benefits additional to carbon sequestration, such as reduced soil erosion, improved water quality and increased biodiversity. The review will explore stakeholder views on whether the current market mechanism provides adequate recognition of the range of benefits provided by the PFSI and if there are other incentives that would assist.

#### *QUESTIONS*

- What are your views concerning the other suggested improvements to the scheme operation?
- What are the benefits and costs of other suggestions for improving the operation of the PFSI?

### 3 Next Steps

1. Feedback from this consultation on the unit type issue will be analysed and a recommendation made to the Minister. It is expected that the Minister will make a decision before 30 June 2013. This will be communicated to participants.
2. The expected process for developing and implementing improvements to the PFSI is:
  - based on the feedback from this consultation, the Ministry for Primary Industries will begin a period of targeted engagement;
  - additional workshops and stakeholder meetings will be held as required, through to the end of August 2013. You can register your interest by email to [pfsi@mpi.govt.nz](mailto:pfsi@mpi.govt.nz);
  - a set of options around the issues or parts of the scheme that need to be improved will then be developed;
  - initial options will be presented Ministers;
  - there will be further consultation on preferred options; and
  - final decisions will be made and implemented – recognising that there may be an 18 – 24 month timeframe if some of the agreed options can only be implemented by legislative amendment.