

Submission to Senate Economics Committee Inquiry into the exposure drafts of the legislation to implement the Carbon Pollution Reduction Scheme

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24 March 2009

Purpose

1. To alert Senators to a major shortcoming in the draft bill concerning CO₂ price signals for 'reforestation' and to make two recommendations.

Background

2. The Government supports 'reforestation' (mainly tree plantations for wood and/or carbon) as a key component of its climate change policy. 'Reforestation' is the only land use activity in the Government's proposed emissions trading scheme.¹ In addition, expenditure in relation to establishing trees in carbon sink 'forests' now enjoys taxation benefits through Subdivision 40-J of the *Income Tax Assessment Act 1997*. In the last 2008 sitting of parliament, the Greens (with tax barrister advice) and the Nationals argued that the legislation, as written, means that land purchase costs and other associated capital costs are fully deductible upfront from 1 July 2007 to 30 June 2012. Such provisions are not available to food producers. The Government argued in the Senate that this interpretation was wrong. Perhaps the matter will only be settled through the court. If the opposition parties' interpretation of Subdivision 44-J proves correct and if 'reforestation' is included as the only land use activity in the emissions trading scheme, we can expect a fundamental change in agricultural land use, away from food production and to carbon sink 'forests'.
3. Whilst the Senate Economics Committee is charged with investigating the draft bill, it is important that its 'reforestation' provisions are read in conjunction with Subdivision 40-J of the *Income Tax Assessment Act 1997*. The policy frame that appears to have emerged over many years of forestry and mining industry lobbying is one of taxation-based subsidies promoting 'reforestation' investment on the supply side combined with, on the demand side, the creation of a CO₂-e market via the Carbon Pollution Reduction Scheme.
4. If the objective is climate, water and food security, this policy frame is incoherent. Furthermore, the statement made in the Commentary (para 6.2) to the draft bill that including 'reforestation' in the emissions trading scheme 'will also allow the Scheme cap to be achieved at lower cost than would otherwise be possible' is only correct if other arguably much less costly and ecologically sound options (within agriculture and self regenerating natural ecosystems) are excluded and the cost of taxation-based

¹ Even if agriculture is included from 2015, CO₂ fluxes associated with land use will not be included. Agriculture, as a sector in emissions trading would include only non-CO₂ emissions, mainly arising from animal husbandry. Soil carbon will not be included under the Kyoto Protocol.

subsidies are not factored in. Drawing attention to these major omissions in the Carbon Pollution Reduction Scheme is not an argument for their inclusion. Rather the CO₂-e measurement difficulties and the stocks and flows nature of the land use carbon cycle calls for all land based activities (including ‘reforestation’) to be excluded from emissions trading and subjected to a separate policy with specific connections to deal with funding and boundary issues, notably biomass feedstocks and energy.

Issue

5. In this submission, I concentrate my comments on one issue in the draft bill: the CO₂-e accounting system for ‘reforestation’, specifically where producers intend to grow wood as well as carbon (that is, excluding permanent ecological plantings).
6. The draft bill stipulates that the number of units to be issued for ‘reforestation’ projects be the ‘net total number of tonnes of greenhouse gases removed’. This is consistent with the *Carbon Pollution Reduction Scheme: Australia’s Low Pollution Future* (the White Paper), which proposed that units for ‘reforestation’ be issued on an average crediting basis; not on an annual basis (section 6.13.4). The argument given is that drought or fire could ‘unexpectedly’ reduce the number of permits in any one year and that annual accounting has high compliance costs.
7. Under average accounting, opting-in wood-producing ‘reforestation’ investors will receive units as the ‘forests’ grow, up to a limit determined by the Authority—the net total number of tonnes of greenhouse gases removed by ‘reforestation’—and must maintain the land as ‘forested’ land after each logging event for 130 years. By averaging, investors receive fewer units up-front but they avoid surrendering units at harvest time.
8. In a world where carbon prices are expected to increase, average accounting isolates wood-producing ‘reforestation’ investors from a rising carbon price. Investors receive units early (when carbon prices are expected to be low) but do not surrender units at harvest when carbon prices are likely to be higher. If carbon prices soar globally in response to a political and public dawning reality of our perilous situation, wood-producing ‘reforestation’ investors who have opted-into emissions trading under the CPRS will receive no price signal to avoid adding to emissions by not logging their ‘forests’. By including wood-producing plantations in the CPRS, the Government will allow the demand for carbon uptake to stimulate plantation investment but, through the accounting rules, will isolate the resulting projects from changes in the carbon price.
9. The first two objects of the proposed Act are to give effect to Australia’s climate change obligations and to contribute to the development of a global carbon market through the CPRS. It is inconceivable that governments around the world engaged in developing a global carbon market wish to create outcomes where projects/businesses, once issued with units, become immune from CO₂-e price signals for the next 130 years.
10. Averaging to remove the risk of rising carbon prices at the time of harvesting is not a consideration for opting in carbon sink ‘forest’ investors, because harvesting is not part of the management plan (although the legislation does not prevent investors from changing their minds at a future date). However, carbon sink ‘forests’ generate another problem for the long-term integrity of a global carbon market aimed at tackling climate change. Without harvesting and replanting, the trees in most carbon sink ‘forests’ will eventually die and release CO₂ emissions because most of the plantings will not be self regenerating native vegetation. With taxation based subsidies for carbon sink ‘forests’ and the CPRS, Australia may build a vast ‘reforestation’ estate that becomes a serious future emissions

liability. There are ecologically and economically superior approaches available for bringing the land use sector into Australia's climate change policy frame.

Recommendations

If the Government retains 'reforestation' in the CPRS:

1. That the draft bill stipulate that the issue and surrender of units for 'reforestation' be accounted for annually, and
2. That the Government guarantee its interpretation that Subdivision 40-J of the *Income Tax Assessment Act 1997* does not provide for land purchase costs and other associated capital costs in relation to establishing trees in carbon sink 'forests' to be fully deductible upfront from 1 July 2007 to 30 June 2012.