



National Farmers'
FEDERATION

**INQUIRY INTO LEGISLATION UNDERPINNING
CARBON SINK FORESTS**

NFF SUBMISSION

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The National Farmers' Federation

The National Farmers' Federation (NFF) was established in 1979 and is the peak national body representing farmers, and more broadly agriculture across Australia.

The NFF's membership comprises of all Australia's major agricultural commodities. Operating under a federated structure, individual farmers join their respective state farm organisation and/or national commodity council. These organisations collectively form the NFF.

Each of these state farm organisations and commodity council's deal with state-based 'grass roots' issues or commodity specific issues, respectively, while the NFF represents the agreed imperatives of all at the national and international level.

Introduction

The NFF welcomes the opportunity to provide input into the Senate Standing Committee on Rural and Regional Affairs and Transport, regarding the implementation, operation and administration of the legislation underpinning carbon sink forests, and any related matter.

The NFF believes that the new carbon sink forest legislation, amending Division 40 of the *Income Tax Assessment Act 1997*, must be amended before it will provide a genuine incentive for farmers to establish of trees for carbon sink forests and induce them to engage in an appropriate level of on-farm forestry. The legislation provides some practical limitations for primary producers claiming the provisions for on-farm forestry. The requirement that the tress must occupy a continuous land area in particular must be removed in order for farmers to make a meaningful contribution to sequestering carbon through on-farm forestry practices without leading to perverse outcomes.

In considering the impacts of this legislation, the NFF also believes that Government must examine the broader suit of current and proposed policies that are designed to drive forestry. In particular, Government must also examine the impacts of Managed Investment Schemes (MIS) and the forestry component of the proposed Carbon Pollution Reduction Scheme (CPRS), both of which have significant potential to influence land use in regional Australia.

All of these policy levers are targeted at addressing specific policy goals such as reducing greenhouse gas concentrations or meeting the notional target of trebling the area of commercial tree crops by 2020¹. The NFF acknowledges that forestry can make a valuable and positive contribution to the environment and the economy. However, Government must recognise the broader ramifications that may emerge if we don't get the balance of incentives right. Collectively, these policies have the

¹ Plantations2020 website, <http://www.plantations2020.com.au/>, accessed on 23/07/08

potential to lead to significant perverse outcomes in areas such as water runoff, biodiversity, social structures and Australia's ability to continue to make a contribution to global food and fibre supplies. The NFF is particularly concerned about the risk to water resources from ill directed forestry decisions. We are already seeing significant ramifications surrounding this issue, particularly in the upper catchments and the south eastern parts of South Australia.

In the context of the climate change issue, we would also urge the Australian Government to review the international accounting rules that are underpinning Australia's domestic action on mitigating greenhouse gas emissions and the carbon sink forest legislation. These international rules place an undue emphasis on reforestation as the primary tool for achieving sequestration, largely ignoring the enormous sequestration potential of agriculture and soils. The Australian Government must not fall into the same trap of ignoring the ability of agriculture to make a significant contribution to sequestering carbon and skewing carbon policies in favour of forestry.

Carbon sink forest legislation

The NFF supports enhancing the potential for small scale, on-farm forestry as a means of complimenting agricultural production while making a genuine contribution to sequestering carbon. Future on-farm forestry practices are currently one of the only recognised carbon sinks for the farm sector and in certain circumstances may provide future capacity for farmers to offset some of the additional costs that will emerge following implementation of the Government's Carbon Pollution Reduction Scheme (CPRS). In addition, the NFF recognises that on-farm forestry can provide shelterbelts, salinity control, erosion control, riparian protection and amenity benefits. The practice can also provide shelter and corridors for native animals therefore adding significantly to biodiversity values.

However, the condition under paragraph 40-1010(2)(a) of the new carbon sink forest legislation states: *"at the end of the income year, the trees occupy a continuous land area in Australia of 0.2 hectares or more"*

This condition places a significant limitation on primary producers claiming the tax provisions for on-farm forestry practices that deliver carbon sink benefits. On-farm forestry practices by agricultural producers will often involve multiple patches of small lots of trees in order to optimise the broader environmental and productivity benefits of such practices. The requirement that the trees must occupy a continuous land area must therefore be removed if Government is serious about providing an incentive for farmers to make a meaningful contribution to sequestering carbon through on-farm forestry practices.

Indeed, the NFF is also concerned that this same condition may instead lead to the perverse outcome of incentivising farmers to plant trees in areas which deliver a

poor environmental outcome, purely in order to maximise the potential claim. Continuous areas may not suit particular landscape planning and may therefore lead to inappropriate land use decisions on-farm. Where rules lead to perverse outcomes such as poor planning and reduction in production and ecological outcomes they must be reconsidered.

The NFF therefore calls for the new carbon sink forest legislation to remove the requirement that the tress must occupy a continuous land area.

The NFF is also concerned that it is incorrect to have carbon sink provisions based purely on a spatial definition. This fails to recognise that carbon stored in a forest is a function of the mass of vegetation rather than area. Agricultural landscapes may have vegetation retained or planted in many configurations.

In addition, the NFF has further concerns that must be resolved in relation to the new carbon sink forest legislation. Firstly, while the NFF believes that there is a low risk that the new provisions, in isolation, will lead to large scale changes in land-use, we are concerned that when viewed in conjunction with existing MIS forestry incentives, that perverse environmental and land-use outcomes may arise.

The NFF therefore calls on a comprehensive review of the full suite of taxation based incentives for forestry in the context of the CPRS. This review must analyse the potential for negative externalities to emerge from the combination of incentives including reduced water availability, biodiversity implications and negative social and economic impacts on rural communities.

We have outlined our views on MIS and the forestry component of the CPRS Green Paper later in this submission.

Secondly, the Government must also ensure that appropriate, comprehensive information is available to farmers on their responsibilities in claiming a reduction for capital expenditure for the establishment of trees in carbon sink forests.

In order for farmers to be able to make informed commercial decisions on the utilisation their land, the broader ramifications of meeting the permanence requirements associated with Kyoto compliant forests must be made clear. This may influence farmer's decisions in relation to issues such as succession planning as well as potentially having implications on their responsibilities with their debt financiers.

Additional policy drivers of forestry

Managed Investment Schemes (MIS)

Managed Investment Schemes (MIS) have proven to be a significant driver of plantation forestry, particularly since the Plantations 2020 Vision was launched by the then Minister for Primary Industries and Energy, The Hon John Anderson MP, in October 1997. Australian Agribusiness Group's seventh annual survey of funds raised in the MIS industry showed the sector managed to raise \$1.079 billion in the 2007/08 financial year. Timber projects received 65% of total MIS funds (\$705 million).²

The NFF has been publicly concerned about the exponential growth in MIS forestry projects and believes that the MIS mechanism does not promote sound investment decisions in rural and regional Australia. We believe that many MIS projects have created negative distortions of resource allocation in regional areas.

The NFF believes that decisions to invest in MIS are largely based on the tax deductibility of the investment, rather than driven by long-term profitability. As a result, MIS have traditionally been primarily focussed on industries with a high proportion of up-front expenses, with little regard given to the output returns that are generated.

On the 21st December 2006, the Minister for Revenue and Assistant Treasurer, Peter Dutton MP and the Minister for Fisheries, Forestry and Conservation, Senator Eric Abetz, outlined new arrangements for the taxation of investments in forestry MIS. The new arrangements, with effect from 1st July 2007, included the following:

- Investors in forestry MIS will be entitled to immediate upfront deductibility for all expenditure provided that at least 70% of the expenditure is expenditure directly related to developing forestry ('direct forestry expenditure'). Direct forestry expenditure comprises:
 - Expenditures associated with planting, tending and harvesting of trees at any time over the life of the investment; and
 - Annual costs of the land used to develop forestry, whether that be effective rental costs or lease payments for land.
- The tax deduction for forestry MIS will be provided by way of a separate statutory provision.
- There will be an integrity rule requiring that arm's length prices be used in determining the value of expenditure directly related to forestry.
- The new arrangements will be reviewed within two years of commencement.

The NFF believes that the changes to the MIS taxation arrangements for forestry have not changed the amount of incentive nor have they influenced the drivers for investors engaging in MIS plantation forestry projects.

² Farm Online Website, <http://theland.farmonline.com.au>, accessed on 23 July 2008

While we acknowledge that the new carbon sink forest tax deductions would not be available to MIS operators, we remain concerned about the impact that MIS is having in regional Australia.

Carbon pollution reduction scheme (CPRS)

The NFF understands the Australian Government's intention to limit man-made greenhouse gas emissions. Indeed, the risks of climate change are heightened for Australia's agriculture sector due to its direct and significant exposure to the impacts of climate change. While the NFF accepts that debate exists on the impact of human activity on climate change, the NFF supports acting now rather than ignoring the risk outlined by the science on climate change.

The NFF recognises the political inevitability of a CPRS and that market-based mechanisms, such as the CPRS, are appropriate for driving least-cost greenhouse emissions abatement across the entire economy. However, Government must ensure that the CPRS design is appropriate and flexible to ensure that sectors, such as agriculture, are not disproportionately affected and that the international competitiveness of agriculture is maintained.

If the CPRS is poorly designed, Australian farmers risk being forced into a position whereby the only way that they can meet their liabilities under the Australian CPRS is by reducing production, which would further fuel the global food shortage and increase food prices. As noted within the Garnaut Interim Report, Australian agriculture is a low intensity greenhouse emitter in comparison with agricultural sectors internationally. Therefore it is in the best interests of the global community to have more of the world's food and fibre production met from countries like Australia, where modern farmers are implementing cutting-edge technologies and greenhouse efficient farm systems.

While the NFF recognises the need for the CPRS to have the broadest coverage as is practical, we have concerns that the proposal for forestry to be able to 'opt-in' to the CPRS, will potential lead to significant distortions in land use within regional areas. In addition, this may lead to perverse environmental outcomes in the areas of water and biodiversity - concerns that have been reinforced by the Government's CPRS Green Paper which states:

The inclusion of forestry on an opt-in basis will provide an incentive for forest landholders, including indigenous land managers, to establish additional forests, or carbon sinks (forests planted for the purpose of permanently storing carbon). This raises other questions regarding potential shifts in land use from agriculture and other environmental impacts such as on water systems and biodiversity.³

³ Carbon Pollution Reduction Scheme Green Paper, July 2008

The NFF calls for further analysis to quantify the level of incentive towards the various levels of forestry as a matter of urgency in order to understand the extent of the land use change risks identified in the Green Paper. This analysis must also be undertaken in the context of the new carbon sink forest legislation and MIS.

International carbon accounting rules

The NFF is concerned that the current Kyoto Protocol accounting rules both misrepresent agricultural emissions and are a barrier to increasing the carbon storage potential of agricultural lands. Under these rules, farmers are restricted from gaining credit for sequestration through cropping and grazing land management practices. As a result, greenhouse emissions recorded for agricultural activities are gross emissions rather than net emissions. These international rules are likely to underpin the greenhouse gas accounting rules for the Australian CPRS and, therefore, limit Australian farmer's capacity to make an equitable contribution to reducing greenhouse gas levels in the atmosphere.

While recognizing the valuable role that trees play in land systems, the NFF is also concerned by the current global accounting rule's emphasis on reforestation as the primary tool for achieving sequestration. A number of factors need to be considered in this regard:

- The current 1990 benchmark for Kyoto compliant offsets fail to adequately address the ongoing sequestration provided by older vegetation forests and by increases in woody vegetation biomass over time. The adoption of a 1990 baseline for vegetation, particularly in Australian landscapes, fails to recognise the transitional nature of woody vegetation cover. Climate, fire, grazing pressure and development have all influenced the extent and density of forest cover in Australia. The current rules devalue pre-1990 forests and create a disincentive for developing countries and Australia to adequately manage and protect existing vegetation. The Kyoto rules need to reflect the ongoing sequestration value of all standing vegetation regardless of spatial characteristics and age, in order to reward good practice.
- Farming demands flexibility in land-use. Locking up a large proportion of the planet's productive farming land under plantations (which could be a perverse outcome of carbon markets) is not compatible with the need to meet the world's growing demand for food and fibre.
- Plantations have significant impacts on water yield. Unplanned land-use change and increased water scarcity resulting from reforestation incentives can have significant detrimental social and economic impacts.
- Monoculture carbon plantations do not offer the range of environmental values that arise from a mosaic pattern of mixed species plantations within productive farming systems. Integrated plantings that encourage biodiversity values and maintain net agricultural productive are more sustainable.

International greenhouse accounting rules that acknowledge sequestration in addition to that achieved through forestry (e.g. in soil and pasture), are needed to enable agriculture to participate effectively in the global response to climate change.

For this to occur, the international greenhouse accounting rules must be changed to make a distinction between human and natural emissions from land systems, such as occur in relation to soil carbon losses. Article 3.4 within the Kyoto Protocol provides options for electing to more comprehensively account for emissions and removals, including the sequestration occurring within agricultural production systems.

For some agricultural production activities, management practices provide the prime driver for patterns and trends in greenhouse gas emissions and sinks. However, in many instances, climate variability becomes the principal driver of emissions trends and sinks, with large inter-annual fluctuations. As a consequence of the climate drivers and the risks arising in terms of projected outcomes in a defined future period, Australia did not elect any Article 3.4 activities.

While there is broad acknowledgement of the inadequacies of such international greenhouse gas accounting rules, the NFF is concerned when it sees that the Australian Government is supporting these same rules within the formation of its domestic climate change policies. This has been demonstrated in the CPRS Green Paper which states:

A shift towards less emissions-intensive activities, including farm forestry, is an intended consequence of the scheme...⁴

Such comments show that the Government, based on the precedent provided by the international greenhouse accounting rules, fails to acknowledge the sequestration capacity of agriculture in its policy thinking, and highlights the ramifications of poor international carbon accounting and its influence on domestic policy formation.

It is therefore important that the Australian Government actively lobby the international community for Kyoto greenhouse gas accounting rules that appropriately account for agriculture and allow the sector to make an equitable contribution to mitigating global emissions. This will also reduce the potential for any perverse outcomes emerging from the carbon sink forest provisions.

Conclusion

The NFF supports enhancing the potential for small scale, on-farm forestry as a means of complimenting agricultural production while making a genuine

⁴ Carbon Pollution Reduction Scheme Green Paper, July 2008

contribution to sequestering carbon. However, the condition that the forest plantings must occupy a continuous land area must be removed if Government is serious about providing an incentive for farmers to make a meaningful contribution to sequestering carbon through on-farm forestry practices. Not doing so could lead to perverse environmental outcomes.

In considering the impacts of this legislation, the NFF believes that Government must examine the broader suite of current and proposed policies that are designed to drive forestry. In particular, Government must also examine the impacts of MIS and the forestry component of the proposed CPRS, both of which have significant potential to influence land use in regional Australia. The NFF calls on a comprehensive review of the full suite of taxation based incentives for forestry as a matter of urgency.

On-farm forestry can play a role in helping to address the climate change challenge. However farmers can also act positively through other agricultural management practices, provided they and the Australian Government can gain credit for these actions. For this to occur, international greenhouse gas accounting rules that acknowledge sequestration in addition to that achieved through forestry (e.g. in soil and pasture), are also needed to enable agriculture to participate effectively in the global response to climate change.

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