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Ministry for Primary Industries  
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## Submission on the Managing Exotic Afforestation Incentives discussion document

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### Introduction

1. Energy Resources Aotearoa (“Energy Resources”) represents people and firms in the energy resources sector, from explorers and producers, distributors, sellers, and users of natural resources like oil, LPG, natural gas, refined products, and hydrogen.
2. This document constitutes our submission to the Ministry for Primary Industries on the Managing Exotic Afforestation Incentives discussion document.

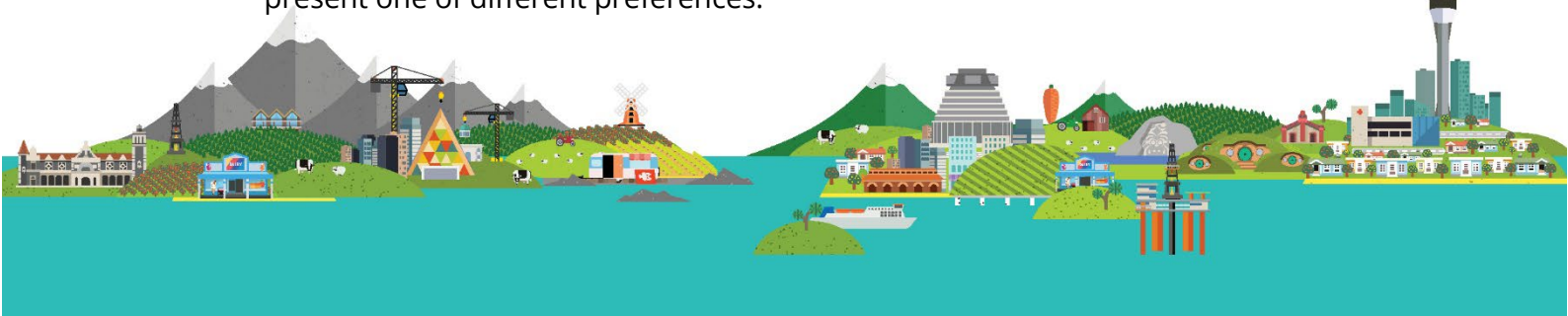
### Overarching and framing comments

#### *The statutory goal and the proper role of climate policy*

3. At its core, emissions policy should be aligned with the domestic statutory goals that give effect to the relevant international treaties. New Zealand has adopted a goal of net zero emissions by 2050 in the Zero Carbon Act.
4. In seeking to achieve that statutory objective, climate policy should remain tightly focussed on achieving what it is designed to do. Trying to achieve broader (non-emissions) outcomes relating to residual or unintended consequences with climate policy is likely to lead to a higher-cost emissions abatement pathway. This matters because it reduces economic welfare for New Zealanders.

#### *The right policy tools should be used to address residual problems*

5. Fundamentally, if certain people are concerned about land use and afforestation, those who think land can be put to better use than the owner’s preferred use should buy the land at an untainted market value. That is a core customary civil process for resolving land use disputes. The core situation here is simply the ever-present one of different preferences.



6. As will be explained in this submission, if the government considers adverse land use impacts will not be resolved through civil means, the right tool is likely to be either pricing externalities or using the land use regulatory regime (e.g., the Resource Management Act).
7. Bans should only be used as a last resort policy tool after more nuanced and sophisticated policies have been tried and, *ex post*, demonstrated to be unsuccessful. Only after that (or where categorical *ex ante* evidence exists) should bans be considered.

#### *The core reason for the preference for afforestation*

8. In public policy analysis, it is crucial to diagnose the cause (and not the symptoms) correctly and to get to the heart of what is driving behaviour. This allows a first principles review of possible actions. We consider that afforestation is an attractive proposition because it is typically the most economic opportunity for abatement in the context of what is, globally speaking, an ambitious goal (net zero emissions) by a relatively early date (2050).
9. That target – and the sinking lid of emission caps that it necessitates – will force abatement, and the revealed preference for afforestation shows that gross emission reductions are often not as economically viable. In other words, afforestation is being used as the ‘pressure relief valve’ or ‘circuit breaker’. If there is a view that normatively undesirable levels of afforestation will happen under the current emissions target, one should ask what other tools can alleviate that pressure.
10. A key tool which is canvassed far too little is the use of legitimate and verified international units (also known as offshore mitigation). Enabling greater access to offshore mitigation would potentially open up lower cost abatement opportunities, thereby reducing the need for as much forestation.<sup>1</sup>

#### *Implications of foreclosing exotic afforestation*

11. Given afforestation is happening for sound economic and commercial reasons, the implications of foreclosing that option must be front of mind. It will fundamentally force higher cost abatement on firms which means either reduced profits, reduced production, or closure. These issues create their own set of welfare problems. It is crucial to consider these issues systemically and to avoid reductionist analysis in the absence of broader context and impacts of decisions.
12. Further, a ban as is being proposed also pre-empts a more sophisticated approach which would consider the relative merits and demerits of new exotic forestry plantation in specific situations. Our prevailing view is these trade-offs are best made as close to the affected businesses and communities as possible, where they are best understood.

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<sup>1</sup> The Climate Change Response Act 2002 has a strong presumption against the use of international units, and we consider this should change.

13. Given the risks of significant policy changes, we consider that credible and robust economic analysis is needed to explore impacts, particularly through computable general equilibrium (CGE) modelling.

### Responses to specific questions from the discussion document

#### **Question 1. Do you agree with our description of the problem? Why/Why not?**

*Comments on "Issue 1: It will drive land use change and displace productive land uses that provide wider economic and employment benefits"*

14. We agree with the points raised on page 12 which outline that afforestation is economically viable and, without further intervention, will be relatively widespread. However, we dispute the "unconstrained" categorisation on page 14 which states:

While carbon sequestration is critical to meeting our emissions budgets and targets, unconstrained permanent exotic afforestation within the NZ ETS has risks for reducing incentives across the economy to reduce gross emissions in the longer-term.

15. In reality, afforestation is not unconstrained as not every hectare will be planted. Planting trees may be a low-cost abatement option for many landowners, but only until it is not. New Zealand does not have unlimited marginal land and there are competing uses, so as the best land for pines is used up the supply of suitable land declines which pushes up the land and carbon price. This makes other abatement opportunities more attractive/competitive.<sup>2</sup>
16. Page 13 states that afforestation will "drive land use change and displace productive land uses that provide wider economic and employment benefits". We worry that this begins to enter a highly normative assessment of what is desirable economic activity, especially when (soon to be) revealed preference of private capital is signalling that land conversions represent the efficient allocation of resources to highest value use. With knowledge being complex and dispersed, it is simply not possible to centrally determine the efficient allocation of resources. Prices are therefore used to should guide this, although policy can be used to internalise externalities etc to smooth any rough edges.
17. In terms of allegedly lost benefits associated with land conversion away from beef and dairy into forestry, we note that upon sale of an asset, capitalisation of earnings means that future benefits are brought into a net present value and realised, meaning that the economic profits of a sold asset do not simply disappear. The purchaser buys an asset because they consider that they can make returns greater than the vendor, making society better off (refer to allocative and productive efficiency).

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<sup>2</sup> Also, foregoing afforestation will mean expensive abatement must be pursued now, even though it is almost certain that in the future lower there will be lower cost abatement opportunities (such as through technological developments).

*Comments on "Issue 2: It may make it harder to achieve our long-term climate change targets"*

18. We are concerned at the core normative views expressed here about what constitutes desirable or acceptable emission reductions.
19. Page 14 states:

Emitters may be able to secure ongoing supply of relatively low-cost NZUs for the lifetime of any new capital investment in emitting technologies (for example, through negotiating a futures agreement of ongoing sale of NZUs with a land owner). Where this occurs, emitters could be able to offset their emissions at relatively low cost, rather than finding ways to reduce them.
20. This last sentence is particularly concerning, given the statutory goal is for net zero emissions. This explicit preference for gross emissions both goes beyond the statute, and also forces higher cost abatement which lowers economic standards.
21. We also note the remark on page 5 of the discussion document that:

With permanent exotic forests being a highly profitable use of land at current carbon price levels, the resulting increase in the supply of NZUs to the NZ ETS from these forests is likely to dampen medium-term carbon prices in the NZ ETS.
22. This commentary reveals a desire for higher carbon prices, in order to (as per page 9) "strengthen the incentive for gross emissions reductions and to manage the amount of exotic forest planting the NZ ETS drives". Again, this represents a normative view on emission reductions that goes beyond the requirements of statute.

*Comments on "Issue 3: widespread permanent exotic afforestation has environmental impacts"*

23. We accept that any land use can have undesirable attributes, and that these may increase with scale. The question is what to do about it and as we discuss, there are more sophisticated (and appropriate) tools than a ban.

*Further comments on the issues identified in the discussion document*

24. Issue 1 and to an extent Issue 2 are concerns about the impacts of afforestation that are, in our estimation, not exclusive at all to exotics (or in fact to any economic activity). The same issues of land use conversion, and reduced pressure to abate gross emissions, both arise under the planting of indigenous forestry. In other words, even if one accepts the problem definition presented, it is not clear to us that precluding one type of forestry does a great deal to alleviate the core concerns.
25. We especially note the comment that "Relative to indigenous forests, a significantly smaller area of land would be required to offset New Zealand's gross emissions through to 2050 with exotic forests." This means that without exotics, even *more* land is required if abatement is still to be driven through indigenous forestry.

26. A ban on new exotics only addresses Issue 3 on environmental impacts from forestry. But even this can be corrected by land use planning or other market-based instruments. The discussion document does not appear to address these points and we consider it to be a serious weakness.

***Question 3. Do you agree with our criteria for managing permanent exotic afforestation? If not, what would you change and why?***

27. Our core concern is that the proposed principles are not focussed enough on the heart of the climate change challenge, i.e., reducing net emissions and ensuring efficient and least cost abatement.
28. We suggest the following principles (in no particular order) also be factored into decision making:
- **long-term stable and durable policy** – it is important that policies to help achieve the emissions transition are stable and durable over the medium to long term. This is because the transition will take place over many decades, so individuals and businesses need to have confidence that choices they make today will not be undercut by sudden policy changes tomorrow. This is particularly important due to the long-term nature of many projects in the emissions space;
  - **least cost abatement** – the transition will be costly, and it is important for it to happen with the least cost to community welfare. Policies should ensure that abatement of emissions happens in a way that is the most efficient and the least destructive to community welfare;<sup>3</sup>
  - **focus on net emissions, not gross** – the statute is clear that the objective is for net zero emissions, i.e., gross emissions minus offsets. Net is also the scientifically relevant measure. The climate is neutral on reductions versus removals; and
  - **employing optimal policy mechanisms** – a focus on net emissions means that policy should target emissions and not a multitude of other objectives. Although spin-off benefits are a bonus, emissions policy should focus solely on reducing emissions. By the same token, where non-emissions impacts or consequences are important, the optimal policy tool should be used to address the specific problem of reducing emissions.<sup>4</sup>

*Comment on proposed Principle 2*

29. We strongly oppose principle 2 (“Supports gross emissions reductions – Afforestation at a level to avoid reducing NZU prices and impacting gross

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<sup>3</sup> In June 2021 we prepared a Perspectives note on *Why a least cost approach to net zero emissions is critical* and this specifically speaks to matter of afforestation on page 5. We published this on our website: <https://www.energyresources.org.nz/dmsdocument/178>

<sup>4</sup> For example, providing direct support to people impacted by climate change or the costs of the transition has never been a purpose of the ETS and there are more effective policy tools to achieve this. If the ETS has distributional consequences that are deemed undesirable, then the state's role in redistribution can be exercised through welfare or tax policy.

emissions reductions.”). Gross emissions are not the statutory focus, and such a focus will force higher cost abatement elsewhere and a corresponding loss of economic welfare.

*Comment on proposed Principles 5 and 6*

30. Although recognising biodiversity and environmental co-benefits are desirable (as per principles 5 and 6 in the discussion document), they should only come into play in the case of ‘tie-breaking’ otherwise neutral choices. This is because emissions policy should focus on low-cost abatement of net emissions.

*Comment on proposed Principle 8.*

31. Principle 8 includes the concept of “...support[ing] the purpose and integrity of the NZ ETS and maintain[ing] regulatory certainty”. We agree that this is critically important, but the proposal fails to meet this standard as explained in our response to question 8 below.

***Question 4: Should we provide for exceptions allowing exotic species to register in the permanent forest category under certain conditions?***

32. The discussion document does not appear to ask whether we support a ban on exotic forestry from the permanent forestry category, so we formally note our opposition to this proposal.
33. If a ban is to be advanced, we certainly support exceptions to allow exotics and in later questions propose methods for this.

***Question 5: Are there particular circumstances that you support introducing exceptions for (for example, exceptions for certain species of exotics)? Why?***

34. Trying to centrally determine how resources should be allocated and used is fraught with difficulty due to the dispersed, complex, and dynamic nature of knowledge. While exceptions to any ban should exist, on principle we prefer market-based instruments to guide decision-making in line with the direction preferred by government.

***Question 6: Are there alternative ways we can recognise and encourage these forests, either within or outside, the NZ ETS? (For example, through the resource management system.)***

35. To the extent that material issues result from ETS settings, offshore mitigation should be a core part of the tool kit as this would mean that forestry is not the default method for low-cost abatement.
36. Land use planning can help to alleviate environmental issues from exotics and the government already has work underway in this space. This would be our strongly preferred approach to managing these issues, as it is the system set up from its inception to do just that.
37. If there are positive externalities from indigenous forestry (such as biodiversity and environmental benefits) that the government insists on resolving through

regulatory means then – as an alternative to a ban – the market could be recalibrated by internalising those costs. Options to do this could subsidising indigenous trees or by creating a special category of ETS units from indigenous forestry. These tools would provide for prices to re-equilibrate across forestry type and allow for market participants to rebalance their portfolios accordingly over time. Such approaches are far more sophisticated than blunt instruments such as bans.

38. It is also possible to penalise exotics (through an extra levy on ETS units granted to exotic foresters), but it is important to note that pricing this is not costless and should be carefully considered before being advanced. Many ETS participants rely on forestry NZUs to meet their compliance obligations so any extra costs will be either passed on or reduce competitiveness and profitability, especially in hard-to-abate sectors.

***Question 8. Do you agree with our preferred approach (acting before 1 January 2023)? Why/why not? If not, what is your preference?***

39. No. The policy process is significantly rushed, and this has major implications for both the quality of policy design and for investor confidence. The new permanent forestry category was only introduced in 2020, and right before it comes into force on 1 January 2023 the government is looking to repeal it. Investors have been looking at afforestation opportunities since the category's inception so to nullify their investment of time and capital sends worrying signals that the ETS is not a predictable and stable regime. This creates sovereign risk which increases the cost of the transition to low emissions as firms seek to price in higher regulatory risk or choose not to invest at all.
40. Proposing a ban merely months out from the new permanent forestry category coming into force creates real sovereign risk and will dampen the confidence to invest. Some important issues of precedent arise from these proposals:
- Until recently, the policy was "lowest cost pathway, the ETS will allocate resources efficiently for an orderly transition...";
  - Today, the proposal is "...except for exotic forestry, which we'd like to control for with a ban...";
  - Tomorrow, it may be "...and only natives in these particular areas, or where X, Y and Z economic co-benefits are realised, otherwise no more removals".
41. As a market-based instrument ("MBI"), the ETS is more delicate than a naturally arising market. This means that particular care must be exercised when considering changes so as to not reduce confidence in the MBI. An MBI only exists because the government created the instrument and structure so, for it enjoy confidence and take-up, participants must be confident that the government will not undermine it with unexpected policy changes. Avoiding this sentiment and concern is critical.
42. Since the NZ ETS provisions were first introduced in 2008, ten core amendment bills have been passed, not to mention many regulation changes. Many of these

changes were critically important and helped deliver the effective ETS regime we have today. But constant tinkering dulls the incentive to invest, and this applies across all asset classes in the affected sector (arguably the whole economy).

## Conclusion

43. New Zealand's statutory goal, aligned with the Paris Agreement, is for net zero emissions. Afforestation is a completely legitimate and important tool for achieving that goal at least economic cost to society.
44. There are customary civil processes for resolving land use issues. Those who think land can be put to better use than the owner should buy the land at an untainted market value. This should, in principle, be the default approach. If the government prefers and can justify a different approach, then pricing in residual externalities associated with (e.g., positive externalities from indigenous trees) is vastly preferable to an outright ban and the possible need to design complicated exemption frameworks. Alternatively, land use planning will also work better than an outright ban.
45. This proposal gives rise to sovereign risk. It will be seen as the government shifting goalposts and will create investment uncertainty. And all in service of a drift from statutory net zero objectives to a newfound prioritisation of gross reductions.