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Ministry for the Environment

By email: etsconsultation@mfe.govt.nz

Submission on a redesigned NZ ETS Permanent Forest Category

Introduction

1. Energy Resources Aotearoa is New Zealand's peak energy advocacy organisation. Our purpose is to enable constructive collaboration across the energy sector through and beyond New Zealand's transition to net zero carbon emissions in 2050.
2. This document constitutes our submission on the Ministry for the Environment's (**the Ministry**) consultation on the redesign of the Emissions Trading Scheme (**ETS**) permanent forest category (the **consultation document**). It should be read in tandem with our parallel submission on the ETS Review, which offers more detail on our high-level views and guiding policy principles, much of which apply here.
3. Following the key points section, this submission makes some overarching points about the policy intent of the consultation, and then offers our positions on the options to redesign the permanent forest category.

Overarching points

The ETS should be focused on its core policy objective – reducing emissions at least cost – with externalities managed by other policy tools

4. We have consistently argued that the design of the ETS should focus on establishing a market price for carbon; based on 1:1 fungibility with emissions; under a falling quantity cap; and consistent with a trajectory to net zero emissions by 2050. The externalities of emissions reductions and removals, such as increased afforestation and its local environmental and social impacts, should be managed through separate dedicated policy tools, such as land use planning and environmental regulations, rather than the ETS which is not set up for this purpose.
5. To this end, the multiple objectives of the consultation document are likely to confuse things, with the ETS expected to achieve all manner of outcomes. For example, we suggest that the additional (biodiversity, etc) benefits of indigenous

forestry could be recognised through non-ETS measures such as biodiversity credits.

We are sceptical that the Government's projections of afforestation will eventuate

6. We see multiple reasons why ETS-driven afforestation might not occur at the scale or speed anticipated by the Government's projections:
 - recent extreme carbon price volatility in the secondary market, driven by:
 - a) market responses to the Commission's 2022 advice on ETS price and unit settings;
 - b) the Government's subsequent decision in December 2022;
 - c) the successful court appeal of this decision; and
 - d) the uncertainty introduced by the ETS review and permanent forestry category consultation;
 - the end of the stock change option for forestry (this had driven an increase in applications ahead of the phase-out deadline, which has now passed);
 - an MPI proposal to charge an annual fee to forest owners to cover the costs of administering the ETS;
 - softening of investment confidence in marginal land in response to recent storm events (e.g., Cyclone Gabrielle) which significantly affected existing and planned plantation and carbon forests; and
 - Overseas Investment Act changes which replaced the previous special forestry test with a benefit to New Zealand test (and recent public announcements by the Opposition that it will ban overseas investment in carbon forestry registered in the ETS).
7. We also expect that other ancillary measures to address the environmental and social effects of afforestation (the Government's 'right tree, right place, right purpose' strategy) will soften the forestry sector's response to a rising ETS price.
8. Given the primary driver of proposed changes to ETS forestry settings is a concern about the prospect of overabundance of (particularly exotic) forestry, we believe the countervailing factors above should be considered and incorporated into expectations about future planting rates.

Commentary on options to redesign the permanent forest category

Design decision 1: Which forests should be allowed into the permanent forest category?

9. As noted in our 2022 submission, and consistent with our argument in paragraph 4 above, we are opposed to an outright ban on the inclusion of exotic species in the permanent forest category.¹
10. The consultation document notes there is some uncertainty about the long-term environmental and ecological risks that permanent exotic forests pose, due to a lack of long-term data in New Zealand. To mitigate this, the Government has proposed a cautious approach – which we understand is to exclude exotic species from the permanent forest category, with possible exceptions canvassed in the consultation document.
11. A better approach would be to establish flexible and adaptive permanent forest management requirements, and to create viable pathways for long-term transition to indigenous forestry. Such an approach would also avoid further significant changes to investment settings and property rights (given exotics are currently allowed in the permanent category).
12. Given the Government appears to have taken a decision to exclude exotic species from the permanent category, and is now considering exceptions, we offer the following points:
 - we support Option 1.2a – inclusion of long-lived exotic species – on the basis it is less restrictive than outright exclusion of exotics, and that some exotic species are well-suited to permanent cover;
 - we do not support Option 1.2b – allowing exotic species on Māori-owned land only – because while we acknowledge large amounts of Māori land may be underdeveloped and would remain so without options to access the permanent category, this situation likely also applies to some non-Māori land. We do not support differential treatment based on the status of the landowner;
 - we support Option 1.2c – inclusion of exotic species in small woodlots – on the basis it is less restrictive than outright exclusion of exotics. It would create more options for afforestation in small lots where no other economically viable options are available. Further development of this option should assess its benefits and costs and test the proposed (arbitrary) 50ha cut-off.

1 Our 2022 submission is available here: <https://www.energyresources.org.nz/dmsdocument/213>

Design decision 2: How should transitional forests be managed to ensure they transition and reduce the financial risks to participants?

13. We support in principle further development of Option 2.2 – a new mandatory specific carbon accounting method for transition forests in the permanent forest category – on the basis this would smooth the financial liability for forest owners and won't change the overall number of units that participants end up with in the long run. It could also offer an 'offramp', wherein transition forests could be moved to the standard (non-permanent) forest category under averaging accounting if transition is unsuccessful. However, the specific accounting values should be carefully considered to ensure they strike a balance between incentivising long-term transition to indigenous species, while also providing sufficient financial rewards for exotic species upfront.
14. The standard carbon accounting method should remain available to permanent exotic forests (whichever exception they are planted under).

Design decision 3: How should permanent forests be managed?

15. We support further development of Options 3.2 and 3.3 (new forest management requirements for the permanent forest category, and for transition forests). The actual implementation of any new requirements should be targeted at specified additional risks and should be proportionate to that risk, to ensure any additional costs for participants and regulators are justified. It might be the case that these could be included in the NES-PF; or might involve the introduction of a new dedicated NES for permanent forestry. We have no strong view on this at this point.
16. Management requirements and enforcement should embrace outcomes-focused flexibility, particularly for transition forestry, given it is a novel model and will likely be iterated over time.

Conclusion

17. The ETS market has been buffeted for several years now by a rolling maul of policy changes and consultations – including both 'routine' decisions around ETS unit and price control settings, as well as commentary on more fundamental policy and design questions (such as this consultation).
18. We appreciate that the ETS is not a perfect mechanism, and like New Zealand's broader climate policy settings, requires difficult trade-offs to be made about the pace and scale of the low-emissions transition.
19. However, our overarching preference is that the ETS is as much as possible left to do what it is designed to: incentivise least-cost net emissions reductions, within a fixed quantity cap that is declining over time consistent with a trajectory to net zero by 2050. We acknowledge the land use decisions driven by the carbon price –

such as afforestation – will have wider impacts on their local environment and communities. But it remains our view that other mechanisms, such as land use planning and environmental regulations, are better suited to address these.