

Submission

CLIMATE CHANGE RESPONSE (EMISSIONS TRADING REFORM) AMENDMENT BILL

Submission to: Ministry for the Environment – Environment Committee en@parliament.govt.nz

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The Forest Owners Association

The New Zealand Forest Owners Association Incorporated (FOA) is the representative membership body for the commercial plantation forest growing industry. FOA members are responsible for the management of approximately 1.2 million hectares of New Zealand's plantation forests and over 75% of the annual harvest.

In 2019, the forest growing sector was worth \$6.93 billion in export value and has a 12% share of rural land use.

Summary

In general, the FOA support the changes proposed in the Bill. The adjustments related to offsetting for post-1989 forests under averaging, consistent treatment of adverse events forest loss, simplifying tree weed exemptions from deforestation liability and a new permanent forest class to replace the PFSI are all supported as logical improvements.

Some proposed approaches are not supported because they will create inconsistency, lack credible justification, and act against the intent of the ETS to facilitate investment in forest growing.

In particular, the exclusion of post-1989 forest land already registered in the ETS from participating in averaging, is not supported. This effectively penalises those who have supported the ETS. It also creates yet another division within an already complicated system for forestry.

For similar reasons we see no reason to limit the use of spatial offsetting or to force forest owners already registered in the ETS to monitor, and report, under two different accounting systems.

In the paper to Cabinet the operational proposals were described as “changes to improve the ETS for forestry participants”. It is important that this is done even-handedly and consistently given that “the ETS is New Zealand’s primary tool for incentivising increased forestry”. Some of the proposed policy does not meet this test and we believe that there are changes that can be made that have no net adverse impacts or cost for the government.

While the bill does not specifically discuss auctioning the FOA is concerned about the rules that will apply. A separate submission has been lodged with the Ministry for the Environment recommending a number of restrictions on auctioned units to ensure that the auctioning system does not undermine the forestry proposals discussed in this submission.

Averaging Accounting

The discussion document notes the previous submissions received that expressed strong support for averaging. We would caution that this should not be interpreted as support for making averaging accounting compulsory. FOA has long supported the concept of averaging for the beneficial reasons stated in the document but have always stressed that it should be an optional approach for those in the ETS.

Under the current proposals averaging will be compulsory after 2021 but will be optional for forests registered in 2019 and 2020.

The FOA acknowledges the alignment between averaging and international reporting and the complexity of maintaining parallel accounting systems as that is a given for qualifying forests established in 2019 and 2020. For any new investors registering in the ETS post 2021 there will be one approach and the rules will be known in advance. For those already invested in the ETS, however, flexibility is warranted.

Allowing the non-compulsory option of averaging for forests registered in 2019 or 2020 is strongly supported. The Cabinet decision not to extend this optionality to those in the ETS registered before 2019 is difficult to understand and is not supported. There are a number of reasons why the FOA considers this decision should be reversed immediately:

1. There is no net cost to the Crown. One of the key arguments put forward by Treasury is that the cost to the Crown is unknown but means that the cost will be spread over time. There may be some temporary earlier book cost, but this will in time be netted out against later lower costs. If the analysis is performed over the full rotational cycles the net fiscal impact is neutral. A possible temporary book value cost only is not a reasonable basis for creating divisions and inconsistency of approach.
2. Officials recommend extending averaging to all forest owners. The Treasury position is at odds with the advice from MFE and MPI officials who consider that averaging should be available to all forest owners.
3. The group of pre 2019 forest owners most likely to be interested in averaging are owners of small woodlots, typically farm foresters and farmers. The option would simplify and de-risk forest management for this group who typically do not have range of age classes to cover their liabilities from other growing forests.
4. Postponing the decision until 2021 is unlikely to provide any greater clarity. One of the reasons given for deferring the decision on pre 2019 forest owners is supposedly that by 2021 the officials and the government will be in a better position to know how many post-1989 forests will be harvested and take up the option. The FOA can see no reason why, in 2 years, the information will be any better than it is now.
5. The ETS should be as easy and consistent as possible. Allowing some existing owners the option of averaging but not others is inequitable and creates yet another unnecessary and artificial division within the forestry rules. Furthermore, any existing owner in this group who plants new forest will then potentially be in a position of having to manage and report

under two different systems for trees growing alongside each other. Officials will also have to monitor them in different ways.

6. The supply of any additional units to the market is not a problem. One of the arguments made is that extending averaging for pre-2019, post-1989 forest owners will increase the supply of units to the market and depress the carbon price. There are several significant flaws in this argument:
 - a. Market experts are strongly of the view that the market is under-supplied – both in the short term and long term – not oversupplied. The additional volumes that could come from averaging may not be precisely known but in the context of the overall volumes already in play will be relatively small and likely to make little difference to the price, particularly over time. The supply of NZ units from forest owners this year to meet the surrender obligations for 17 million tonnes worth of emissions had a relatively modest, and short-lived, impact on prices providing evidence that the possible additional post 1989 units are going to have minimal impact.
 - b. Not all pre-2019 foresters will be interested in averaging, of those that are some will not be selling their units, of those that do they will come to the market over time. The concern around additional supply seems to come from the currently high unit registry balance. The assumption seems to have been made that all of those units could be available to supply the market. That is not the case. Many of those units are being held either for surrender at harvest or on a long-term basis.
 - c. Notwithstanding the two points above, at the moment the government’s main concern seems to be around the impact of an increasing price of carbon. Currently, there are very conflicting signals coming from Treasury and MFE with a \$25/t price recognised as too low to change the behaviour of industrial emitters or individuals, yet there is concern that the price may be too high. The FOA looks to the Productivity Commissions 2018 modelling in its low emissions Economy report for guidance on price (Fig 3-11, page 85).] We would have expected that anything that helps moderate the increase in price, would have attracted strong government support
 - d. Any additional supply of units will increase liquidity in the market and mean NZ has less reliance on international (manufactured or “thin air”) units to meet demand. Both are healthy for NZ and the ETS.
7. Many pre 2019 ETS foresters will not transition to averaging. The FOA has always argued against making averaging compulsory on the basis that we have members who have already entered the ETS on a stock change approach and wish to continue under the same arrangements. This group will typically have larger estates. These larger holdings enable them to adequately manage their harvest liability risk through growth in other parts of the estate or through alternative species to radiata (principally Douglas-fir). This shows that there is a significant percentage of the membership and representing a significant area of post-1989 ETS registered forest, that do not want to avail themselves of averaging. The

proposal to exclude post-1989 forest owners from being able to use averaging will be of most concern to those foresters who wished to move to a less demanding reporting system without liability at harvest so long as the forest was replanted. This is likely to have been of particular interest to those with smaller blocks with limited age classes even if it involved accepting a more conservative level of carbon credits.

Non-compulsory averaging for ETS registrants committed to saw-tooth management

The FOA considers there are very strong grounds for not making averaging compulsory after 2020 for those who are already registered in the ETS and who are already operating under a saw-tooth regime and who do not wish to convert to averaging. There is a significant group of post-1989 forest owners registered in the ETS who have no interest in averaging. These are typically forest owners who have, or were intending to have, a sufficient spread of volume and age classes to adequately enable them to offset harvest liabilities in one stand against credits associated with growing stands elsewhere. There are four compelling arguments why such investors should be allowed the option of continuing with a saw-tooth regime post-2020. They are:

1. These owners may have invested on the basis of the existing ETS rules with the intention of developing the necessary age classes (a “normal “forest) but not yet be in that position. Not allowing them to complete the job is retrospectively penalising them for following the investment signals that the ETS delivered.
2. Forcing new planting into averaging could also interfere with some contractual arrangements for sale of NZUs. Some of the foresters intending to plant to balance their spread of volumes and age classes have contractual arrangements in place that rely on them being able to continue their planting program to that end. Preventing those foresters from completing their planting program in carbon accounting (by forcing that new planting into averaging) could interfere with those contractual arrangements. This could have serious consequences both for the forester involved and for the buyer of the NZUs who is relying on them to meet their ETS compliance obligations.
3. As currently proposed, these foresters will be forced to operate two reporting systems and that means MPI officials will have to do the same with the same forest owner (rather than dealing with forest owners who have all their forests under one system or the other).
4. Regardless of whether the Carbon stock change (“saw-tooth”) investment is allowed for these foresters post-2020 MPI will nonetheless have to operate a Carbon stock change accounting system for the existing forests that are not under averaging. Allowing the same registrants (but not new registrants) the ability to increase their hectareage is not adding any substantial level of complexity or cost for MPI

Offsetting

With the potential exception of permanent forests, spatial offsetting should be extended to post-1989 carbon-accounting forests.

Increased flexibility for offsetting of pre-1990 forest and to limit enforcement action is supported. The ability to offset post-1989 forests will be made available for those using averaging just as it already exists for pre-1990 forestry. This is logical and supported. Again, however, an inconsistency is created by not extending offsetting to all post-1989 forestry. This doubly penalises those post 1989 foresters who are being denied the ability to switch to an averaging approach.

As with averaging almost all submissions argued that offset planting should be available for all post-1989 forest.

Flexible land use is in New Zealand's best economic interest and would allow land that was better suited to farmland or other purposes to be made available at no financial or environmental cost. The FOA was part of the NZ delegation to the UNFCCC which secured international endorsement of FLU (Flexible Land Use) as an approach "the international offsetting rules apply to all post-1989 forests from 2021"¹. Extending FLU (offsetting) to all post-1989 production forests would be consistent with this.

[1] Emissions Trading Scheme forestry accounting proposals, Regulatory impact assessment, MPI Paper No 2019/01, para 388; also, para 83

It is noted that in the discussion paper forest offsetting is not proposed to be made available to permanent forests (during or at the end of the no clear fell period). While, in principle offsetting permanent forests is defensible from a climate perspective, the FOA acknowledges, particularly for indigenous forestry, an off-setting re-establishment that takes generations to establish may involve other considerations including biodiversity preservation and soil stability. It is also acknowledged that in securing FLU internationally it was agreed that it was only intended to be made available for offsetting one industrial plantation with another and not to extend to old growth natural forest.

Adverse events

There will be no liability for adverse events loss of carbon in permanent post-1989 forests so long as the forest is replanted.

The FOA supports the policy intent of removing a barrier to the establishment of permanent forest and the acknowledgement that without this change the cost of insuring against such events will often exceed the income from the forest. The same logic, and recognition that it is not reasonable to penalise for Acts of God, should be extended to all forests as long as they are restored.

Stand down period after harvesting unregistered forest

Unregistered post-1989 forest land that has been deforested and re-planted will be prevented from being registered in the ETS for a period of time until the forest has established. This is intended to remove the incentive to deforest and start again. Any reforestation within a minimum period (the indication is 15 years) will be considered second rotation.

While the FOA understands the concern about early harvesting in order to maximise the benefit of entry in to the ETS the stand down period will cause undesired and unintended consequences. For any owner of an unregistered forest who wishes to enter the ETS this will pose a question of exactly what they do with the land during the stand down period. After a period of several years any land

left untended will support a dense cover of weeds, gorse etc. This time period will be sufficient to make the ETS registration (and therefore the ability to access carbon income) uneconomic and, accordingly, it may also be enough to put them off replanting and staying in forestry.

We acknowledge that selective harvesting on a sustainable yield basis will be permitted by requiring at least 30% canopy retention but point out the apparent policy conflict with NES-PF regulation 63, which requires that a minimum of 75% canopy cover be maintained to qualify as “low intensity harvesting”.

New permanent ETS forests to replace PFSI

In 2021 PFSI participants will have option of joining the ETS as a post-1989 forest (stock change or averaging) under a new permanent (50 years clear fell restriction) forest category or exit and remove all their forests from carbon accounting

We agree that the PFSI is overly complicated and unnecessarily expensive (compared to ETS registration). It has had limited uptake and yet permanent forestry should be an important option for many landowners and with minimal obstacles.

The FOA also concurs with penalties that adequately disincentivise early clearfall of permanent forests but considers this is best set in quantum of carbon units rather than dollar amounts which may bear no relation to the value of the carbon in the future.

HWP – Harvested Wood Products

MPI have advised that this policy remains under development and options to incentivise the processing sector are being looked at. Our understanding is that consideration is being given to attributing all of the credit associated with harvested wood products to the processing sector. The FOA considers that the creation of harvested wood products is the consequence of investment decisions taken by both growers and processors and accordingly any recognition should be spread across the industry. Providing all of the credit to processing is not consistent with this and is not a position that was recommended by officials, or previously supported by the pan forest industry body, the Wood Council of New Zealand.¹

The FOA would be supportive of the creation of a pan-industry funding pool that could be used for the benefit of the industry as a whole. This is also the only practical way of providing recognition to the processing sector given the significant challenges that would be faced by trying to incorporate that part of the value chain in to the ETS. In addition, as with all carbon credits, the issue of how liabilities are managed must also be dealt with.

¹ See submission https://www.woodco.org.nz/images/stories/pdfs/WoodcoHWPSubmission_29_April_2016.pdf

Non-forestry announcements

Two other system wide announcements made at the same time are relevant:

Phasing down of industrial allocations. The free allocation to industrial emitters will be phased out 1 per cent per year from 2021-2030, then at 2 per cent from 2030-2041, and at 3 per cent per year from 2041-2050. This will not affect the free allocation to the agricultural sector which is being considered separately and FOA will be submitting on that issue.

Phase down of free allocation to industrial emitters. The FOA supports the proposed phase down of NZU's in three stages from 2021 to 2050.

Recognition of pre-1990 additionality

While not specifically referenced in the Bill we note that there is an important area of work which the sector has been seeking progress on for a decade. It is our understanding that a programme of work is underway to assess the potential for recognising legitimate 'additional' sequestration by pre-1990 forestry. This is a legitimate area to recognise for both the forest owners and New Zealand and is acknowledged as such under the international accounting rules.

International Units

The lack of clarity about the degree of reliance New Zealand will place on international units and how this will be determined has not been diminished by the bill.

The New Zealand ETS, and the forest sector, have suffered from allowing unrestrained access to international units in 2012 and 2013 and it is to be hoped that this lesson has been learned.

Allowing offshore units "if there has been a significant change in circumstances", assuming that there are any available, appears to be at odds with relying on a level of them to meet our international targets.

Auctioning

Consistent with the above positions the FOA considers that it is important that auctioning of units in the ETS is carried out in a way that maintains integrity and does not undermine the forest investment signals intended in this Bill. Specifically, the FOA position is that auction participation be restricted to only those emitters with obligations and the units be classified as "permits to pollute" to distinguish them from NZU's, have an expiry date of two years, and not be available for secondary trading.

Further input

Thank you for the opportunity to submit on this Bill. The FOA and FFA would like to be heard should there be an opportunity for oral submissions on this Bill.

A handwritten signature in black ink, appearing to read 'D Rhodes', with a stylized flourish at the end.

David Rhodes, Chief Executive, Forest Owners Association