

Submission

on

Forestry in the ETS: Proposed updates to cost recovery tranche two

MPI Discussion Paper No:2023/05

Submission to:
Cost Recovery Directorate
Ministry for Primary Industries
PO Box 2526
Wellington 6104
costrecovery@mpi.govt.nz

3 May 2023

Contents

- Contact Details 3
- Submitter..... 3
- Summary 3
- Specific concerns 4
- Proposed alternative approach..... 9
- Consultation Questions (5.2.5)..... 9
- Note on making this submission public..... 10

Contact Details

David Rhodes
Chief Executive
Forest Owners Association
Level 9, 93 The Terrace, Wellington.
Email david.rhodes@nzfoa.org.nz
Web www.nzfoa.org.nz

Submitter

The Forest Owners Association (FOA)

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 70% 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

Even with a short extension being granted, the period to respond has been inadequate and does not represent meaningful consultation. The decision to provide an extension came with only days remaining to the original deadline and it has precluded more extensive quantitative analysis of the impacts across the membership although it is clear the impacts are substantial. This is contrast to the year the Ministry has had since the first tranche of proposals to develop the consultation document.

FOA has significant concerns about the magnitude of the proposed cost recovery charges and the approaches suggested for implementing them. We consider alternatives are available that better meet the cost recovery principles. The FOA is not opposed to cost recovery that is applied on an equitable and reasonable basis. By way of example the association was an early supporter and adopter of the GIA framework for cost-sharing biosecurity readiness and response. We do not consider that the proposed Emissions Trading Scheme (ETS) cost sharing is reasonable or equitable. In particular, FOA submits that:

- the respective government/industry contributions to cost recovery do not reflect the large public good benefit and are not consistent with the support that government has provided to other sectors when dealing with the management of greenhouse emissions.
- the proportion of cost recovery lumped under the proposed annual charge is unjustified and a far greater proportion should be cost-recovered from fees which reflect actual usage and provide an incentive to be judicious with the demand on services.
- there is an unwarranted emphasis on the value that participants are deriving from the ETS which we contend is not relevant, and the document fails to record the level of liability that participants also carry.
- the demand on services does not increase in a linear relationship with area.

- the discussion document inappropriately tries to defend cross-subsidisation on the basis that some users may face high costs. This is a distortion of cost-recovery, unjustified and masks the cost signal to users.
- the approach to cost recovery opens participants up to indefinite, and unknown, future costs.
- the reasoning given in the document for dismissing alternative options to the proposed model is flawed. FOA considers some of these alternatives are a better option than the one favoured by Ministry for Primary Industries (MPI).
- the proposal does not incorporate a review, or plan for a review, of the efficiency of the considerably expanded system that now operates.

Specific concerns

1. Cost recovery principles are not met

The cost recovery principles on page 12 supposedly underpin the proposed approach. “MPI applies four cost recovery principles to determine the best approach to situations”. They are Transparency, Justifiability (reasonableness), Efficiency (net benefit maximised) and Equity. Of these four, “MPI can cost recover only if it has first sufficiently met the Transparency and Justifiability principles”.

We contend that the proposals fail both these foundation principles as well as failing the equity test. Our reasoning is as follows:

Transparent?

Concealing the true running costs of the system in an annual charge is an inappropriate distortion and certainly not transparent.

Reasonable?

The FOA supports improvements that make the system more efficient, but the orders of magnitude increase in cost are exceptional. To move from requiring industry to meet 6% of the costs of a much cheaper system to meeting 63% (page 18) of the system now estimated to be costing \$30M annually is not reasonable, particularly given the large, and undisputed, public good benefit and the national need to encourage further planting.

The order of magnitude increase has taken place after landowners entered the system on a different premise, this adds further to the unreasonableness of the proposal.

Efficient?

If the objective is to achieve maximum net benefit for MPI then the test may be met. For users to be confident that the system is efficient there needs to be an independent review of (or independent provision of) the system

Equitable?

The document openly concedes that higher recovery from those with larger holdings is being built into the system because it is considered that if other users had to face the true cost of their portion of the system cost, this would be an unfair burden. This breaches any definition of equity.

The document states that “beneficiaries pay 100% of costs of a service they use unless there is a strong efficiency or equity reason they should not.” This does not just apply to beneficiaries as a group but also to any individual beneficiary. The user pays principle should apply, especially as no strong efficiency or equity reason has been given as to why this should not be the case.

2. The justification of annual charge is inadequate

Under Section 3.2 (page 12) there is a description of private good versus club good. The description provided is too simplistic including, for example, the statement that the IT systems benefit all forest ETS participants. Only some of the IT system benefits all. Numerous elements of the system may never be used by some participants.

If a significant component of the system is tied up dealing with applications that are inadequate, or need extensive checking, resubmission, or are non-compliant, there is no justification for those who are unaffected or have spent time and money providing adequate information, to be cross-subsidising this additional attention. The statement that all of the IT system is a club good (page 20) is rejected.

Applying an annual fee regardless of the level of use of the services is a blunt instrument. The amalgamation of variable costs associated with providing a suite of services with a non-variable, fixed fee is inequitable. The document states that “*Charges that are too low will result in a high level of demand for services*”. This necessarily means demand is variable and not fixed and, accordingly, cost recovery charges should be the same.

The examples of “club services” referred to under paragraph 5.1.1 that “*support the core functions of forestry ETS administration, and ensure it runs efficiently, is robust, and protects value for all participants*” can easily be built into a fees structure. Indeed, the definition of what are club services is being manipulated to suit the preferred outcome.

From the figures provided the proportion of cost faced through charges is 15%, while a massive 85% of the cost is being lumped into an annual charge that is not related to usage. This may address MPI's cost recovery needs, but it does not provide equity to the people paying those charges. The system should retain a user pays discipline wherever possible.

3. Hectares is a poor basis for determining activity, and therefore use, of the system

It is stated (page 20) that club good costs are proposed to be based on land holdings because the larger the landholdings the greater the value the system will provide. There is no logical basis for this statement, nor is it backed up by any evidence. Indeed, we believe the contrary to be the case. Larger landholdings and therefore larger entries in the registry come hand in hand with efficiencies of scale. A forest of 50,000 hectares will not place a demand on the system that is 1,000 times greater than a 50-hectare forest.

Applying cost recovery system on the basis of area based on hectarage is in effect penalizing efficiency, the exact opposite of what the system should be doing.

The following statement is made at the top of page 25 – “*total hectares per participant in the ETS is more stable and predictable than forecast service volumes, we expect that this approach will generate more predictable and reasonable charges through time whilst also having some relationship to demand*”. This statement neatly sums up the whole basis for the proposed charging regime and has minimal justification. Just because it is easier does not mean to say it is justified. Dictatorship can also be quite stable and predictable but that does not mean we should select it as an option.

4. Owners will be disincentivised from reducing demand on the system by a fixed charge

Owners of large multi-age class forests generally have good access to expertise and resources and are therefore much better at undertaking what they would otherwise be asking MPI to do.

If they are going to be asked to pay a fixed annual charge regardless of demand, and to cross subsidise others placing a higher demand on the system, there will be no incentive for them to minimise the demands on the system, in fact the opposite.

5. There is considerable uncertainty about the efficiency of the system

The government has created an administratively complex scheme, which is costly for both MPI and forest industry participants to manage and administer. The system that was supposed to have been completed by 1 January 2023, continues to grow with further unknown costs still to come. The forest industry has ultimately had little say in its design. While we accept the ongoing justification for the current, and already increased, specific transaction fees, and perhaps to their future indexing to inflation, we consider the system needs independent review.

6. The public good element is much higher than presented

The opening paragraph of the discussion document makes it clear that the ETS is a policy tool under the emissions reduction plan (ERP) “*to help meet New Zealand submission budgets, domestic targets and international climate obligations*”. It specifically acknowledges that the ETS has been established to incentivize emissions removal through forestry. In addition, paragraph 4.2 acknowledges that the ETS “*stimulates overall economic activity across New Zealand*”. A better description of something designed to advance the public good would be hard to find. Suggesting that those who have been encouraged to participate should now fund two-thirds of this public good policy instrument does not recognize its primary purpose.

The degree of reliance of the nation on carbon-incentivised planting to achieve national emissions reduction targets means that the public good element here is paramount and the private/public contributions to cost should reflect that. Any potential reward (and liability) that forest owners have, associated with the establishment of new forests, is appropriate and is needed to achieve national targets. To introduce such a radical shift in the balance of costs by definition sends a signal that the importance of forestry sequestration is no longer as important for achieving public good goals as it was when the scheme was introduced and yet this is not the case.

It is suggested that the 37:63 ratio should be reversed.

7. The consideration of beneficiaries is too narrow

As well as recognizing the public good element there should also be a recognition that the benefits of the system extend well beyond just those who register forests.

The consultation document describes the types of costs being recovered on page 12 as *a fair proportion of wider business support or common costs, for example costs associated with corporate functions like finance, human resources management and costs of property and utilities*. FOA submits that ETS emitters are also receiving net benefits from their use of the system that would fall under the categories described above – as well as other categories.

Whilst the consultation document states that the costs recovered should be paid, in part, by those that benefit financially from the ETS system i.e. ‘*club good*’, we argue that ETS emitters are also receiving benefits to their business from the system and therefore should also contribute. The ETS framework has been established to allow an accurate, and internationally defensible, exchange of offset units that helps emitters achieve least cost abatement. It is as much in their interests for the rigor of the system to exist as it is for the providers of such units.

We submit that in MPIs consideration of equity for the cost recovery proposal, that forestry ETS participants should not be considered in isolation from other users of the ETS. The significant burden and scale of the costs proposed for forestry participants only is not equitable, ETS emitters whose businesses also receive benefits from use of the system, should be required to shoulder a proportion of the financial burden alongside forestry participants.

We propose a transaction fee for emitters using the ETS to share the burden of cost recovery across **ALL** participants in the ETS.

8. The proposal is inconsistent with other government approaches to apportioning costs

The proposed approach raises a significant issue of equity with other rural land users, with whom forestry competes for the use of rural land. If levies of this scale are to be imposed on commercial production forestry ETS participants, then it becomes distortionary in this land market if a similar level of costs of participation are not likewise imposed on say, He Waka Eke Noa participant farmers, permanent native forestry enterprises etc. Similarly, agriculture is required to face only 5% of its ETS costs and also receives considerable subsidization of research from the auction funds.

Two thirds of the forest industry is pre-1990 forest and often under the same ownership as those participating in the ETS. The carbon in these forests has been appropriated by the nation with a minimal level of compensation provided. These landowners now face liability if changing land use, and on-going administrative costs, without any ability to derive sequestration income.

9. There will be a negative economic impact, particularly under averaging

We fully agree that any cost recovery makes forestry less economical, even to a minor degree. This will certainly impact Māori landowners, as noted on page 22, but this negative impact is not exclusive to Māori. It will diminish from the attractiveness for all landowners of establishing new forest and registering it within the ETS. To that extent it will work against the objectives of the nation's climate change targets.

Owners of forests under an averaging regime will face the biggest negative impact and cost recovery is being applied in the absence of a clear understanding about the corresponding level of demand. The same concern around termination of credits will be shared by those operating under the stock change approach where those participants are managing NZU sales under a minimum sustainable carbon level ("safe carbon").

It is conceded on page 18 under section 5.1.1 that "*it is currently unclear what the use of these enduring services will be by participants with averaging forests and how this will change*".

10. The relevance of the value of NZU's to cost recovery is over-stated

A heavy emphasis is being placed throughout the document on the value of NZU's to forestry participants, notably in paragraph 4.3.1.

We fail to see how this is relevant to cost recovery. Does this mean that if the price of carbon falls, the cost recovery fees, and annual charge, will also be reduced? Conversely, does it mean that if the carbon price doubles then MPI would consider a doubling of the cost recovery charge would be justified. This is the signal that is being sent.

The argument that if you can afford it, you should therefore pay, is not appropriate. Such an approach is tax revenue, not cost recovery.

The document also fails to record that with credits come obligations. Why is there not a corresponding table on page 15 showing the liabilities that a forest owner in the ETS has?

It is also clear that the system will be heavily influenced by political decisions outside of industry's control. There has been recent clear evidence of how the value of ETS units is influenced by government policy despite the existence of an independent Climate Change Commission whose advice on the ETS has been ignored.

Finally, it is noted in the discussion document, these proposed changes are taking place at the same time that other changes are being implemented to confine the potential benefits the forest owners may receive, notably averaging, and increased restrictions within the permanent category.

11. There has been insufficient consideration of alternatives (page 24)

The section on the consideration of alternatives is unconvincing and we wonder why MPI did not consult the industry on the alternative options. This would hardly have compromised any commercial sensitivities.

We note that MPI *“has reviewed historic data for the proposed fixed fees and considers that the time the fees are based on will limit any risk of participants paying for services they will not benefit from”*.

In part, this is because the proportion of the cost being attributed to fees is much less than it should be because it is being subsumed within the annual charge.

MPI has concluded that *“for the two services with proposed tier charges, setting one fee for all forest sizes at an average cost was considered to be less equitable with smaller forest owners paying a far larger share of the costs than they should given the proportionate greater time (and therefore cost) to provide these services for larger forests.”*

While we can accept that in general there could be a greater level of cost associated with forests of significant size, this does not mean that the alternative extreme should be implemented, namely that they will be a linear application on a per hectare basis. This creates a similar inequity when it is also clear that a forest that is ten times bigger does not necessarily create a demand on the system that is 10 times bigger.

Equity demands that the approach must be a compromise which we consider is best dealt with through establishing a series of bands.

We further consider that inadequate evaluation has been undertaken of the option to incorporate IT costs within the hourly charge out rate (page 25). Similarly, in the next paragraph the option of cost-recovering the proportion of IT costs for satellite imagery through fees is again dismissed on the basis of a fear of uncertainty and supposed, unexplained, inequity issues.

The argument is made in both cases that the alternative approach may require significant deficits/ surpluses to be carried through in the next fee reset. We consider that this risk is being overstated.

Firstly, MPI has a record of historical usage that would enable a reasonably accurate projection to be made. Secondly, at the aggregated level (which is where MPI are operating), any surpluses and deficits will cancel each other out. If there is an overall modest level of cost required to manage this before the next reset this seems to be a small price to pay for having a far more equitable system that is based on costs faced by those using the system. This would also be a reassuring discipline to include that might help constrain the use of resources that will otherwise run the risk of being over-utilised because users are not facing the true cost of their provision, and we will end up with an even more expensive system.

The document acknowledges, page 16, that there is plenty of scope for varying the charges and therefore a blanket, one size fits all, solution that covers 85% of the costs is not only unjustified but unnecessary.

Proposed alternative approach

The Forest Owners Association supports the general principle of cost recovery, so long as this is equitable with how all parties are being treated under the emissions trading scheme, including those currently exempt from it.

The FOA considers that an approach that better meets the principles of cost recovery would be one that:

- Recognizes that the public good element is far higher than 37% and is consistent with the approach that the government is taking to dealing with other sectors such as industrial and agricultural emissions. We propose that the public good element arising from ETS participation justifies a two-thirds contribution by the government.
- Shares the burden of cost recovery across **ALL** participants in the ETS, we propose a transaction fee for emitters using the ETS.
- Reapportions a much higher level of the lowered cost to fees instead of an annual charge (2:1 would be more appropriate).
- Applies a sliding scale in recognition that the use of the “system” by owners of larger forests covered by the same application do not represent a linear increase in costs over smaller units. A series of bands should be developed.
- Has a ceiling cap on cost that any one entity can face.
- Places a time limit on the annual charge faced by landowners who are deriving no further benefit from the ETS (averaging).

Consultation Questions (5.2.5)

Questions

1. Do you agree with the proposal to introduce new fees relating to 22 services? What are the reasons for your answer?
Yes and no, see above.
2. Do you agree with the proposal to introduce a new annual charge relating to six services? What are the reasons for your answer?
Yes and no, see above.
3. Do you have any comments around MPI’s assessment around the four cost recovery principles?
Yes, you have failed to adequately meet three of them.
4. Please describe any impact the proposed fees and the annual charge might have on you and/or your business/organisation. Quantify this if possible.
Modest to horrendous. If we had been given more than 17 days to respond we could have considered quantification.
5. Are there any other issues with the proposed fees and the annual charge that you think Te Uru Rākau – New Zealand Forest Service should be aware of?

Plenty, see above.

6. Are the proposed methods for apportioning costs between participants reasonable? Could they have a disproportionate impact on certain participant types or groups? Please provide examples of impacted groups if disproportionate impacts are foreseen, and the drivers for this.

No, the apportionment is not reasonable and there is the ability to apply something that is more equitable.

7. To what extent do you perceive potential unique implications for Māori because of the proposed cost recovery settings? What are the reasons for your opinion?

Considerable implications but very few of them are unique.

8. Do you feel the annual charge is reasonable, do you consider there will be differing impacts from the annual charge on various forest sizes/type or accounting approaches?

No, this is the biggest issue we have with the proposal. The size and proportion in the annual charge is unjustified.

9. When considering the services provided, how do you think any ongoing annual charge should interact with forests that are under the averaging accounting once the long-term average carbon stock has been reached?

The concept of continuing to charge people indefinitely after any benefit has finished but liabilities remain is clearly acknowledged as an issue, but MPI have not offered a solution despite having much longer to consider the issue. In the absence of any other solution we believe that a time cap needs to be included otherwise it will be a significant deterrent to participation in the ETS.

Note on making this submission public

We do not object to the submission being made public.



David Rhodes
Chief Executive
Forest Owners Association