FOREST OWNERS ASSOCIATION

Submission

On

Te Arotake Mahere Hokohoko Tukunga – Review of the New Zealand Emissions Trading Scheme

Submission to:

Ministry for the Environment
Wellington
https://consult.environment.govt.nz/climate/nz-ets-review

11 August 2023

Trees for our future

Contents

Contact Details

Rachel Millar
Environmental Manager
Forest Owners Association
Level 9, 93 The Terrace, Wellington.
Email rachel.millar@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 2023, the forest growing sector was worth $6.69 billion in export value and has a 12% share of rural land use. The Ministry for Primary Industries expects forest product export values to exceed $9billion by 2030.[1]

Summary

FOA submits that:

1. Fundamental changes are being proposed on the basis of inadequate analysis and questionable assumptions about forestry offsets supply.
2. We have no issue with the stated objectives and assessment criteria. The government should be continually evaluating its progress against the Climate Change Commission (CCC) recommendations, the likely achievement of carbon budgets, and our Nationally Determined Contribution (NDC). Where we do have a problem is in the premature conclusion that this is currently necessary, and that the only option is to constrain forestry units. The FOA is particularly opposed to options 3 and 4.
3. It is recognised the New Zealand Emissions Trading Scheme (NZ ETS) has been the main tool for reducing greenhouse gas emissions over the last 14 years (page 6). We acknowledge that adjustments will be needed from time to time but it is also important to maintain as much consistency of signal as possible for long term investors. The NZ ETS is not broken, and the instability seen in recent times has been more about Government's lack of commitment to CCC recommendations than with any structural problems with the system.
4. We note that *"before the government makes its final decisions on the NZ ETS review, detailed modelling and analysis will be undertaken".* It is clear that, at this point, there is little

[1] https://www.mpi.govt.nz/dmsdocument/41319-fit-for-a-better-world-background-analysis-on-export-earnings-in-the-primary-sector

understanding of how these inadequately informed proposals will impact existing NZU's or registered forests (page 54). The document admits the evidence and assessment of cost abatement curves is not well developed, and that further analysis will clearly change what officials consider to be the optimal pathway (page 34).

5. Unfortunately, none of this has stopped a document being made public that makes it clear the government has already concluded that the ETS is not performing as it should, and it will be selecting from a limited range of options to correct this. All of the options for change fundamentally change the basis of investment for forest owners and, not surprisingly, the unintended response from them has already begun.

6. As noted (page 55), there are other options already at the Government's disposal that could be employed but that have not been. These should be utilised first before concluding that the system is broken and needs sweeping changes. Key amongst these options are constraining the supply of units through auctioning, and reducing the supply of free NZU's to *"at risk"* industries.

7. We agree that an increasing carbon price will ordinarily result in an increasing level of afforestation. However, as we point out below in the section on "*New Zealand's Climate Change Response*" there are multiple policy and regulatory measures emerging that are going to constrain investment in forestry. While the document does numerous times acknowledge that afforestation will need to be encouraged somehow this is nothing more than conceptual at present and provides no reassurance to investors. The limitations to the analysis are starkly summed up in the acknowledgement that "*it is not possible to predict with certainty how private actors will respond to policy changes*", nor any "*changes to removal activities*" nor even "*future rates of afforestation"*.

8. Consequently, in the near term we expect a considerable drop in the level of planting which will take time to reverse, even assuming positive encouragement of forestry is restored. Investment confidence has been severely dented and this will take 2-3 planting seasons to reverse.

9. As well new planting being less than estimated we consider the likelihood of achieving the agricultural reductions upon which the CCC's budgets are predicated, is also low particularly as the timetable for action is already being deferred. The critical He Waka Eke Noa piece of the jigsaw receives a solitary mention and no discussion on the consequences of failing to make progress are included. This is despite the CCC finding that "*even short delays in acting to reduce gross emissions could result in increasing larger shortfalls in future emissions budgets*".

10. The combined effect of both of the above factors means that the difficult task of achieving our NDC of reducing net emissions by 50%, below 2005 price levels for the period 2021-30 (page 16) has been made even harder. The suggestion that the shortfall could be made up through purchasing offshore units (page 17) will be both deeply unpopular and highly risky. It is also a concern that this cost has not been mentioned in the section that discusses financial impacts on the taxpayer (page39). We agree that one of the key considerations for assessing proposals is that "*The NZ ETS helps Aotearoa achieve the 2023 NDC and future NDC's, as much as possible through domestic actions*" (page 49).

11. If Government exercises some of the options at its disposal such as restricting its own supply of units to auction and reducing industrial allocation we consider this will absorb a significant level of any new supply from forestry.

12. We are not convinced that there is sufficient evidence to conclude that forestry is in an over-supply situation. However, we would support the situation continuing to be monitored, and if more robust data clearly illustrates that supply is in excess and jeopardising gross emissions reductions then this can be managed through restricting the level of entry for forest offsetting to the NZ ETS. Consistent with this, we consider it reasonable to amend the Climate Change Response Act 2022 to require the Government to consider the incentive for gross emissions reductions or the supply of forestry units.

13. Multiple times the document notes that the NZ ETS was not designed to create a separate pathway for emitters and then the conclusion is drawn that the NZ ETS is faulty for not doing so, and one is needed. We do not accept that without a separate pathway the NZ ETS cannot provide an adequate signal to emitters. The prime reason it has not consistently done so and that we have not had the desired increasing price is because the Government has failed to follow the CCC's advice or, itself, intervened unnecessarily in the supply to market. A clear case of the worker blaming his tools.

14. We consider that the level of consultation with the forest sector (one of the key sectors impacted by the proposals has been inadequate). We note, for example the webinars made available for iwi, the public and youth but none for the forest industry. Furthermore, changes are being proposed on the basis of draft advice from the CCC without waiting to see if this advice is subsequently amended on the basis of the consultation being undertaken. All of this suggests a pre-determined outcome and not genuine interest in alternate views.

15. Any legitimate, cost-justified, additional removals that are currently not recognised in the NZ ETS should be. New Zealand should not be holding back on claiming offsetting. Any implications this has for supply and action on gross emissions should be dealt with subsequently, it should not be a reason to prolong or defer recognition.

16. In summary, the FOA is gravely concerned that significant decisions around land use and the NZ ETS are happening on a preconceived basis without proper consultation and without detailed consideration of the significant flow on effects – which are already starting to play out. We consider that, in a drive to deliver greater gross emissions reductions, New Zealand will instead end up failing to meet its net reduction targets – an order of magnitude bigger problem.

Chapter 1: Introduction and Context

The Minister makes it clear, page 6, that *"we need the NZ ETS to incentivise both emissions reductions and carbon removals from forestry".*

The discussion document notes in a number of places (e.g. pages 14 & 20) the additional desirable benefits that forestry provides in addition to removing carbon dioxide from the atmosphere including enhancing indigenous biodiversity, improving freshwater outcomes, providing economic opportunities for landowners particularly on *"land that may otherwise be hard to make a living from*" and providing erosion control.

What is not mentioned, but is also highly relevant, is that afforestation also reduces biogenic methane emissions through displacement of ruminant livestock. Also not mentioned is the increasingly important reliance on forestry to supply bioenergy needs. By way of example, the

recently announced commitment by the government and Air New Zealand to develop aviation fuel notes the limited global supply[2].

New Zealand's climate change response.

Reference is made (page 14) to other significant pieces work that will influence forestry investment including the National Environmental Standards for Plantation Forestry (NES-PF) and the Ministerial Inquiry into Land Use in Tairawhiti and Wairoa (the Ministerial Inquiry).

As is noted (page 20) there are many work streams in progress at present that will either reduce or prevent afforestation. The impact of these measures, and stated policy intentions by both main political parties, will be cumulative and major. The handbrake signals include but are not limited to:

- Constraints and restrictions to be applied to the Permanent Forestry category.
- Restrictions or bans on overseas investment in the NZ ETS, including existing processors who are trying to expand their resource supply.
- Additional but unknown local authority control on forestry land use.
- Additional operational requirements arising from the Ministerial Inquiry.
- Loss of workforce capacity as a result of market and cyclonic impacts.

The expectation that the NZ ETS will continue to incentivise significant reductions and removals (page 20) is concerning. The price of carbon is only one factor influencing voluntary participation in the NZ ETS. Currently that price, combined with the above factors, has shattered confidence in the NZ ETS. We are aware of numerous investment plans that have been cancelled by both onshore and offshore investors and in some cases withdrawal from the NZ ETS. The FOA will not derive any satisfaction from being proven right with our predictions and, if our assessment is correct, reestablishing investor confidence and the capacity of nurseries to supply will take time, likely 2-3 years, as has been demonstrated in the past.

The document notes (page 15) that our domestic target requires gross emissions of biogenic methane from 24% to 47% below 2017 levels. We question the likelihood of achieving this target, particularly in light of the uncertain outcome for the He Waka Eke Noa partnership. The equation is simple, and not open to compromise. Any lack of progress on methane reductions must necessarily be made-up somewhere else if we are to succeed in reaching our targets. As noted, New Zealand has set a NDC of reducing net emissions by 50% below price 2005 levels for the period 2021-30 (page 16).

Meeting our climate change goals (page 17).

It is suggested (page 17) that the gap between projected net emissions and New Zealand 2030 NDC target of 99 Mt CO2e could be met through either greater emissions reductions or buying reductions offshore. We suggest that the option of attempting to satisfy any shortfall through offshore mitigation will be problematic because spending billions of dollars offshore is likely to be highly unpopular with New Zealanders, and there is also no guarantee that the units sought will actually be available. Any concerns about the balance between net and gross emissions reduction at home are likely to pale into insignificance if set against the option of spending $23.7 billion (page 17) of

[2] https://www.stuff.co.nz/business/132307714/air-new-zealand-and-government-scope-feasibility-of-making-sustainable-aviation-fuel-in-new-zealand?cx_testId=20&cx_testVariant=cx_1&cx_artPos=3#cxrecs_s

taxpayers' money on sequestration offshore. We also consider that because of the lack of progress on methane reductions, and our expectations of a significant fall in the level of afforestation because of a range of government initiatives to control or prevent afforestation, the dollars needed to be spent offshore could well exceed the estimates provided on page 17 by some margin.

The NZ ETS stockpile (page 18).

The document raises concerns about the large supply of NZU's in NZ ETS stockpile (page 18) and the CCC's 2021 estimate that this was around four times the number if units surrendered in 2021. Those figures are two years old and much has happened since then including a number of failed auctions with more likely. The stockpile is nowhere near its previous level and even then caution is needed in assuming that these units are all "available". We no longer think it is accurate to include a statement in the document that the current size of the stockpile may limit the effectiveness of some of the options (page 19).

Why the Government is reviewing the NZ ETS (page 19).

The conclusion that the NZ ETS is currently expected to deliver significant exotic forest afforestation and limited gross emissions reductions (page 19) relies on afforestation continuing to be significantly above the long-term average. While last season's plantings are likely to be well above average, we consider there are multiple reasons that, together, will mean that this level is not sustained. If this happens, then it also necessarily means that emitters will not have the supply of NZU's from forestry and therefore the pressure will increase to take action on reducing gross emissions.

Aotearoa needs significant afforestation to meet its emissions reduction goals (page 20).

It is noted the Government accepts that that there should continue to be support for removals, and talks about the need to review the design and settings of the NZ ETS (page 21) but little clarity is provided beyond that on exactly how this will occur and thus those making a decision about whether to commit to planting have no additional reason to do so.

As stressed above (in the Section on New Zealand's Climate Change Response), we have zero confidence that current planting levels will be maintained at anywhere near the level needed to meet the reduction goals. The message that forestry must be constrained from impeding progress on gross emissions reductions is being well and truly heard. The equally important message from the Minister that we nonetheless must have a minimum level of offsetting to have any hope of meeting our targets is being buried.

The document is almost completely silent on agriculture and yet, by definition (page 13) gross emissions reductions include agricultural emissions. If we are confident that greater progress can be made on gross emissions reductions, does this mean that there will be consistency of approach and we should expect that access to forestry offsets will also be constrained for the agricultural sector just as for other gross emitters? If not, then immediately half of the gross emissions equation is being left out of considerations as well as their reliance on forestry offsets. As we have cautioned elsewhere, if the CCC's anticipated progress of agricultural gross emissions is not realised then we either need more forestry offsetting or we send more money offshore.

There is a single reference to He Waka Eke Noa on page 23. Despite prolonged and difficult discussions on this sector-offered alternative to agriculture being in the NZ ETS, no agreed approach

has been finalised and the original timetable is already being pushed out with the prospect of it being abandoned if there is a change of Government.

The current budget projections from the CCC critically rely on progress on agricultural emissions, just as they do on progress on other gross emissions. We contend that applying the brakes to offsetting when it is far from assured that we will achieve such progress is a high-risk strategy that puts our international commitments at risk.

Multiple times it has been pointed out that the Government does have the option of restricting supply through its own actions, notably by not creating and making available units at auction. We reject that statement that "*the government cannot drive faster and greater gross emissions reductions*" (page 24).

The Government has agreed to assess whether changes are needed to the NZ ETS (page 21).

It appears the Government has not only agreed to assess but has already come to a conclusion. We note the reliance being placed in the document, and by Government, on the draft 2023 advice and, in particular, the "*recommendation that the NZ ETS be amended to separate the incentives for gross emissions from those applying to forestry*" (page 21). Given that this is draft advice that the CCC is still engaging on, and the CCC is not due to deliver its final advice until the end of the year, we question the value on committing time and resources to any further engagement with the CCC, despite their reassurance that the report is only a draft and our views are important. Certainly, more generic advice was provided by the CCC last year (as discussed below), but this is a much more specific recommendation that has not yet been finalised. It is poor process and not what we consider to be genuine engagement.

Previous engagement (page 22).

While the FOA supports the call for action on gross emissions there is also clearly strong support for a focus on net emissions with around half of previous submitters stressing the importance of the combined impact of sequestration and removals. Just as the agriculture sector have noted, gross emissions reductions ahead of the technological innovations that are needed, but not yet here, is very challenging. The strong implication from the discussion document is that emitters have plenty of choice to reduce gross emissions reductions and are simply choosing offsetting because it is a cheaper option. We would contend that until the cost for both emitters and taxpayers of making significant in-roads into gross emissions reductions, the majority of people will be supportive of using offsetting to give us breathing space. Far better that than to be forced to back away from commitments already made, as the United Kingdom has just had to do in dropping its climate pledge. Least cost abatement should be shunned only when the economic impact for Aotearoa is acceptable. New Zealand is not sitting on easy options for meeting our targets and "*Aotearoa is still one of the highest emitting nations in the world per capita*" (page 6). We should be thankful we have a relatively modest level of land available that is suitable for offsetting. Even when posed a leading question in previous consultation about whether they agreed that widespread, or high levels of permanent afforestation may make it harder to achieve New Zealand's targets many people disagreed, and the point was made strongly that if Government is sufficiently concerned about the level of NZU's it should look to moderating its supply of units to auction.

Chapter 2: Expected Impact of current NZ ETS

The NZ ETS is expected to drive large-scale exotic afforestation to reduce net emissions (page 20). Given the current uncertainty we no longer believe this statement can be relied on.

Question 2.1: Even in the context of the current NZ ETS we do not consider this to be a realistic scenario anymore. As described above, there are now so many pending changes and questions for which answers are unavailable, that large capital investment in decades long investment will fall significantly. We are already seeing this in the industry.

It can be argued that a fall in land prices will provide a self-correction by the market to offset the uncertainty and fall in the price of carbon. This relies on landowners accepting that the value of their property is well below what it was just a few months ago but, even at a reduced price, the purchaser still needs to understand what the rules are around the carbon market before that can be factored into any purchase price. Confidence can be restored but, realistically we consider it will take two to three plantings seasons for this to happen, even with the right signals.

The NZ ETS will not be able to maintain a strong and stable emissions price (page 28).

It is telling that this section commences with the statement "*If the modelled supply and demand dynamics become a reality…..*". We consider that there is significant uncertainty attached to the assumptions and expectations and, the consequence of ushering in a fundamental change to the way the NZ ETS has been operating without being more certain is a high risk that New Zealand will be forced to exercise the only option remaining to it – purchasing billions of dollars of reductions from the international market as a price-taker. As stated many times, FOA agrees that forest offsetting should not be compromising progress on emissions but we do not share the view that we have reached the point where this is an issue, and that we will continue to have an over-supply of forestry units. As noted, the much-vaunted surplus that had the potential to cause so much disruption to the price and undermine stability is already a fraction of what it was just 6 months ago.

Impacts of exotic afforestation (page 29).

There has been considerable confusion caused in the public arena by not clearly defining what type of forestry is being discussed. This has resulted in a level of tension that has been unhelpful and that detracts from a conversation about the integration of food and fibre interests in an increasingly discerning international market.

Permanent (non-production) exotic forestry is sufficiently different to exotic, production forestry that it warrants separate consideration in terms of policy needs, as is indeed happening with the parallel discussion document. This section of the NZ ETS document is adding to the confusion by introducing the topic of "exotic afforestation" and then describing *"key challenges"* that are related exclusively to permanent forestry issues. The heading needs changing even though the damage is already done.

Question 2.4: We strongly disagree with the summary of the impacts of exotic afforestation. As explained above this illustrates a fundamental lack of understanding by the authors of this document about the different types of exotic afforestation.

Chapter 3. Driving Gross Emissions

Decrease cumulative emissions (page 31).

The document notes that 50% of the gross emissions we need to reduce are from agriculture and also records that "*the Commission found that even short delays in acting to reduce gross emissions could result in increasing larger shortfalls in future emissions budgets*". We have had more than a short delay on progressing an agreed approach for managing ruminant methane and nitrous oxide emissions and are likely to experience continuing difficulties in arriving at a solution. Given that, what is the plan B to having sufficient offsetting and where is the discussion on the implications?

Keep Aotearoa in step with other countries (page 32).

New Zealand has a completely different emissions profile from the Annex A countries that we are comparing ourselves with. We remain a big farm with a relatively small population. Our profile much more resembles an Annex A developing country under the global climate framework than on a per capita basis we can justifiably make a claim to be amongst the most efficient producers of food in the world. This will not stop expectations of what our NDC should be on the national stage. Nor, however, should it stop us defending our ability to use land use change to help sequester carbon and concurrently reduce livestock emissions.

The majority of the production forestry being established in New Zealand is well managed under independently audited, and internationally governed, environmental standards. We are also one of the few countries in the world to have an operating Emissions Trading Scheme. While the few others operating an ETS do not include forestry that does not mean they are not encouraging forestry off-setting. Australia is a prime example of that. We consider New Zealand's reputation to be high and not at risk from balanced approach that we have adopted.

A number of people have commented in the media, including the Climate Change Commissioner that offsetting is becoming discredited. We strongly refute that and challenge anyone to produce evidence that this is the case. The FOA readily accepts that there is offsetting occurring internationally that is causing issues, most notably the replacement of old growth rain forest with plantations including oil palm.

The offsetting that is of concern globally is typically that where fast-growing tree plantations are replacing old growth forest. This is why the IPCC has raised concern at "*planting large scale non-native monocultures, which would lead to loss of biodiversity and poor climate change resilience*". But this is not what is happening in New Zealand. The transition from pastoral agriculture to forestry results in a net increase in biodiversity and is an essential element for meeting our NDC. To conclude from the IPCC statement that all offsetting is now a dirty word demonstrates either a lack of awareness, or alternate motives.

A strong and stable ETS price (page 33).

We concur that a strong and stable ETS price is desirable for all parties, but we do not consider the current NZ ETS is unstable. The prime reason we have seen instability in the ETS, most recently, is because Government has either chosen to ignore the CCC's advice or because it has indicated that it is considering fundamental changes to the rules that investors entered the scheme under. Other than this the ETS price signal has increased strongly and steadily in line with what the CCC projected. A great way to achieve stability is for the Government to stop making wholesale changes to the rules.

Question 3.2: We do not agree with the assessment of the cost impacts because the document readily concedes that the basis for that assessment is weak. There is an acknowledgement (page 33) that the officials understanding of price and behaviour has room to improve. It is conceded that

the marginal abatement cost curves have limitations (page 34) and involve uncertainty looking forward. Furthermore, the CCC states that it is wanting to understand what prices should look like to prioritise gross emissions meaning, necessarily, that it doesn't currently know.

It is also concerning that the document states that "*as better information becomes available, our estimates of the optimal pathway will change*". We recommend that the further assessment that is clearly needed to deliver an adequate understanding is undertaken before relying on *"indications"* as a basis to make fundamental changes that may or may not be justified; and may or may not deliver the expected outcome.

A comprehensive package of measures if needed. (page 36).

We fully concur that a portfolio of levers provides a more effective and balanced approach to both lowering emissions and increasing removals and, in particular, that the NZ ETS alone will not deliver sufficient removals even though it is a vital component.

Question 3.1: We agree with driving gross emissions reductions through the NZ ETS. For the reasons given above we do not agree that this means fundamental change is needed to the NZ ETS. We strongly agree that the price of carbon associated with the NZ ETS needs to rise alongside complementary measures. We do not agree, however that "*this implies that the design of the NZ ETS needs to…..create a particular pathway for emitters*". The fact that the NZ ETS was not designed to do this does not imply that it is therefore faulty and cannot deliver the necessary change. This is a step in the logic that is not supported.

Increasing the NZ ETS price could affect household costs (page 39).

The impact on households, particularly lower income households of rising fuel and energy prices is noted but no mention is made of the cost that will ultimately have to be borne by households of spending billions of dollars offshore on offsetting instead of utilizing the homegrown option.

Removals will play an important role in meeting our climate change goals (page 41).

Question 3.3: Maintaining incentives for removals is critical and the NDC will not be achieved without them.

As has been noted many times "*removals, including from forestry, will be critical for meetings future NDC's which are expected to be progressively more aggressive*". We agree that an increasing carbon price will incentivize greater afforestation, principally exotic. If there is evidence that shows this to be an over-supply for emitters then the simple solution is to review this regularly and to constrain supply in to the ETS if required. The proposed alternative of fundamentally altering the rules within the NZ ETS risks confusion, a lack of confidence and, more importantly, risks achieving the removals that are so vital. This is not justified when there are simpler, less complicated and less expensive options.

Chapter 4: Significance for Maori

Question 4.1: We agree that there are differing views from, and varying impacts on, Maori. This is also a conclusion that the FOA has come to from the feedback it has received and illustrates the broad, and at times conflicting, factors that must be weighed up when considering kaitiakitanga. This balancing act is not unique to Maori and is reflected in the wider landownership population.

There is, however, a disproportionate level of underdeveloped land, often remote and financially constrained, that has disadvantaged Maori landowners. The ability to utilize carbon revenue has provided a generational opportunity to transition land from an unproductive state to one that better suits the inter-generational aspirations of the owners.

Question 4.3: As with all landowners, we defend their right to manage their property in the way that best suits their needs within the law. This will vary. The NZ ETS has a job to do to incentivize land use change and we reject the view that sheep and beef farming has some inherent priority right to productive land. We support Maori being able to access carbon revenue, including through the use of fast-growing *Pinus radiata* to transition to native, so long as this is not resulting in productive land becoming non-productive land. The Government should resist dictating use of land but does have a legitimate role to determine the extent to which its policy, the NZ ETS, drives land use change.

Chapter 5: Objectives and assessment criteria

Question 5.1: We agree that it is appropriate for the Government to review the balance between gross emissions reductions and maintaining removals, especially as the CCC has noted this as a concern. We also agree with the secondary considerations, in particular that "*The NZ ETS helps Aotearoa achieve the 2023 NDC and future NDC's, as much as possible through domestic actions*".

Any policy changes will need to be considered very carefully and with greater confidence in the data collated. We have already seen significant action taken by investors in response to even proposed changes. We share the concern that *"prioritising gross reductions in the NZ ETS limits the access of emitters to removals and will likely reduce the incentive for these removals (if no additional action is taken)."*

Our acknowledgement of the appropriateness of the objectives and assessment criteria should not be read as support of the proposed solutions.

Chapter 6: Options identification and analysis

We do not agree with the statement that the four options listed in Chapter 6 "*indicate the different changes the government could make".* They only cover some of the changes the government could make; and it is concerning that some other options are not canvassed.

Complementary policy measures (Page 52).

This section is very important as it hints at what alternative encouragement may be provided to ensure that the much-needed level of forest offsetting is still achieved. Unfortunately, none of the measures (biodiversity credits or a domestic voluntary carbon market) are more than conceptual at this point and have no time frames. As such they do not provide sufficient assurance to forest investors in comparison to the strong signal that their NZUs will become less valued.

Limitations of the options analysis (page 53).

The limitations are starkly summed up in the acknowledgement that "*it is not possible to predict with certainty how private actors will respond to policy changes*", nor any "*changes to removal activities*" nor even "*future rates of afforestation*.

We note that "*before the government makes its final decisions on the NZ ETS review, detailed modelling and analysis will be undertaken*". It is clear that at this point, there is little understanding of how these inadequately informed proposals will impact existing NZU's or registered forests (page 54). Unfortunately, this has not stopped a document being made public that makes it clear that the Government is selecting from a range of limited options that all have fundamental implications for forest owners and response has already begun.

The stockpile creates some uncertainty (Page 54).

The bank of NZU's that is cited as potentially dampening the carbon price "*if they were sold en masse*" has already shrunk considerably since the discussion document was released and is likely to fall further in upcoming auctions. There has also been no *"en masse"* selling to date and it is hard to see why any given price would suddenly be considered the trigger point for selling by multiple investors given that they will all have their own reasons for holding and selling. Both of these factors mean that this risk is now negligible. As noted, the stockpile also provides essential liquidity and avoids market dominance.

A number of assumptions about how participants will act are listed but then the document also, correctly, notes that there is no certainty as to how participants will act (page 53).

Option 1: Use existing NZ ETS levers to strengthen incentives for net emissions reductions (page 55).

As described, there are several options open to Government to reduce supply and these should be looked to first to drive gross emissions reductions as the NZ ETS was intended to do. We agree, all things being equal, an increasing carbon price will result in an increasing level of afforestation. However, all things are not equal and there are multiple policy and regulatory measures under development that will constrain investment in forestry.

In the near term we expect a considerable drop in the level of planting which will take time to reverse, even assuming positive encouragement of forestry is restored. If Government exercises some of the options at its disposal such as restricting its own supply of units to auction and reducing industrial allocation this will absorb a significant level of any new supply from forestry. We are not convinced that there is sufficient evidence to conclude that forestry is in an over-supply situation. However, we would support the situation continuing to be monitored, and if more robust data clearly illustrates that supply is in excess and jeopardising gross emissions reductions then this can be managed through restricting the level of entry for forest offsetting to the NZ ETS. Consistent with this, we consider it reasonable to amend the Climate Change Response Act 2022 to require the Government to consider the incentive for gross emissions reductions or the supply of forestry units.

Option 2: Create increased demand for removal activities to increase net emissions reductions (page 58).

We see little downside in the Government providing itself with the ability to purchase NZU's outside the NZ ETS. This is not a mutually exclusive option and does not prevent the government taking other action if required but does provide the Crown with another control lever.

We agree, however, that there will be close to zero interest from offshore emitters if they cannot claim the reduction themselves.

Option 3: Strengthening incentives for gross emissions reductions by changing the incentives for removals (page 62).

FOA is opposed to option 3 on the basis that:

- The justification for it has not been demonstrated.
- Because the extent and timing of intervention by the Government will be unknown it will significantly, and negatively, affect investor confidence.
- Retrospective imposition of rules on those who have already invested is not being ruled out and this is already having a negative impact on investment and forest management behaviour.
- It will, as conceded in the document, result in less removal activity.
- There are other, better, options, if needed.

As discussed above we consider there are already numerous actions in play that we expect to constrain the interest in forest planting and removals for the NZ ETS. This policy would exacerbate that problem.

Option 4. Create separate incentives for gross emissions reductions and emissions removals (page 65).

FOA is strongly opposed to option 4 on the basis that:

- The justification for it has not been demonstrated.
- This option has the potential to make the system so complicated as to be unworkable and at best ineffective.
- It will add considerable and unnecessary cost.
- Retrospective imposition of rules on those who have already invested is not being ruled out and this is already having a negative impact on investment and forest management behaviour.
- It will, as conceded in the document, result in less removal activity.
- There are other, better, options, if needed.

This option is very concerning given the lack of analysis to support it and the lack of any detail about how the second removals market would operate. It is an option that should have been consulted on after final advice was received from the CCC and at a time when sufficient detail could be provided to assess whether it could achieve its objectives. As noted, design and confidence are completely unknown at this point and there is an implication that it will take a long time to design and implement (page 67).

Monitoring and managing dual systems is likely to very difficult for both participants and the Crown. Based on the blown-out cost of the existing NZ ETS, there is every reason to expect that this will be duplicative cost. We are already seeing a proposed ten-fold increase in cost-recovery largely driven by the much higher than expected costs of running the existing NZ ETS. Operating a dual system runs the risk that these costs will become prohibitive. The additional cost of designing, implementing and running a second system has not been factored in to the "costs to economy and household" on page 67.

The comment that "this option "*could provide more investment certainty for foresters that the status quo (depending on the design and purchase behaviour)*" (page 67) is a truism. Of course, anything is possible when the design is a blank piece of paper and we do not have the core information. Until that is provided there is no logical reason to support this option.

The option has also not ruled out the government becoming the single purchaser of units and removing the element of competition. This will certainly undermine confidence and leaves the actions of the purchaser open to other than the core functioning of the market.

This option fundamentally alters the basis upon which existing removals investors have chosen to voluntarily participate in the NZ ETS. A further rule change mid-investment of placing restrictions on the removals stockpile has also not been ruled out.

Removal activities are removed from the NZ ETS, and no alternative mechanism to incentivise removal activities is provided.

We are surprised this was even identified as an option. The reference to this obviously counter-productive possibility seems to be to make the other 4 options seem more palatable.

Consultation questions (page 69).

Question 6.1 and Question 6.3: As recommended above, we consider that the government has effective tools for controlling supply and these should be employed before other options which are clearly needing more analysis and clearly going to create complexity and cost are even considered. As such we favour option 1 and, for the reasons given, do not consider the increased incentive for removals will result in a dampening of the price.

If there is clear evidence that this does eventuate that it the time to consider more interventionist, and radical changes to the rules that investors have operated on to date.

Question 6.4: Are there any additional options that you believe the review should consider?

As well as considering what viable options the Government may have at its disposal it is also critical to decide when any such options are justified and making sure the evidence for intervention is conclusive. The FOA has made it clear on numerous occasions that removals contributing to net emissions reduction should not compromise progress on gross emissions removals. We consider it is premature to be concluding that the removals are on a sufficiently sustainable level of increase that they will compromise the gross emissions objectives.

In addition to the levers discussed under option 1, another option that has not been discussed would be to control the level of entry of forestry units or hectarage in to the NZ ETS. This could be done, and reviewed, on an annual basis taking in to account the CCC's advice. This could also favour those applications for NZ ETS entry that have additional beneficial qualities (a shortfall of the other options noted in Chapter 7) or lower negative implications, including consideration of other species.

This option should only be applied if there is compelling evidence that the supply will significantly exceed the desired demonstration path level of planting. If it were to be applied it has the advantage of being less administrative, less costly, less confusing and allows investors to know their circumstances before they have entered the NZ ETS.

Chapter 7: Broader environmental outcomes and removal activities

The NZ ETS could be expanded to include a wider range of removals (page 72).

Question 7.3: Should a wider range of removal be included in the NZ ETS?

The FOA supports the recognition of any legitimate (internationally recognized and credible) removals including additional vegetation on farmland, wetlands and pre-1990 forestry. This support, however, is conditional on the removals meeting the criteria outlined on page 73, permanent and scientifically valid. We also agree that removals should only be included where the cost of doing so does not exceed the value of the recognition and note the riparian margin and

tussock-land examples (page 74). New Zealand has, thus far, established a robust and internationally credible measuring and monitoring system. This should not be put at risk by allowing removals to be recognized that cannot meet these criteria, or introducing costs that are unjustified.

Question 7.1: Should incentives in the nz ETS be changed to prioritise other environmental co-benefits?

The FOA cautions against turning the NZ ETS into a multiple objective mechanism that compromises the prime objective. In general, we consider that where there are other benefits being delivered these should be recognised in their own right, and separately such as through a biodiversity credit system (page 76). To do otherwise risks inadvertently penalizing the most efficient removal activities; and the carbon goals and NDC are paramount in priority.

We note the concern about additional recognition under-mining gross emissions reductions but this is not a justification for not recognizing any removal that do meet the criteria; it is merely an additional factor that will determine whether the Government needs to apply any of the tools at its disposal or other options to curb supply. It is a concern that the document implies that legitimate additional sequestration may not be recognized if it is considered it would deliver too much supply (page 73).

Recognizing removals as part of the agricultural emissions pricing system (page 75).

We strongly enforce the comment that "*On-farm activities will need to be considered consistently across different schemes*".

Note on making this submission public

We do not object to the submission being made public.

Rachel Millar
Environmental Manager
New Zealand Forest Owners Association