



## NZ ETS Review 2016- Forestry and Operational Matters

Thank you for the opportunity to submit on the NZ ETS. My involvement in carbon forestry pre-dates the NZ ETS and spans over a decade. New Zealand was the global pioneer in creating a government mechanism for privately owned tradeable forest emission units with the Permanent Forest Sink Initiative (PFSI).

When the PFSI was finally introduced in 2007, countries, business and individuals looked to NZ and saw major opportunities. In those early days hundreds of millions of dollars lined up for major investment into programs totaling over 200,000ha of new permanent forests, and countries such as Denmark described the PFSI as a “best practice forest mechanism”.

Fast forward 8 years to the present and carbon forestry in NZ is in disarray. The millions in investment never eventuated, few new plantings have occurred, deforestation is back on the rise, and the environmental credibility of the ETS has been tarnished with major rort occurring in both the forestry and emitter sector via the use of suspect overseas Kyoto units. New Zealand has lost 8 years to get tree planting restored to a level to meet future emission targets. It is a wasted opportunity.

To restore confidence in the carbon forestry sector will require major change to the system, and to Government objectives. Recent comments from Minister Bennett have been encouraging however more than rhetoric is required to repair the damage caused to date.

### NZ ETS review: Forestry technical note

#### Existing structural design settings

##### F1. What do you consider are the strengths and weaknesses of the NZ ETS forestry settings?

“After my experience with the NZ ETS I would never again factor carbon credits into the economic analysis of a prospective forest investment” *Client who was looking at planting 100ha in 2016*

Weaknesses:

**Price volatility** is difficult for forest owners. Major disincentive is potentially repaying units at harvest at a higher price than when selling them. This may also lead to illiquidity in carbon market due lack of supply coming to market and being banked instead to meet harvest liabilities.

**Policy change** creates uncertainty. Forestry is long term investment requiring certainty.

**Government commitment** to role of forests is lacking. The rhetoric is present but action is absent. Government protects emitting industry, especially agriculture at the expense of forestry.

**Inability to adapt** rules quickly to address issues before the compound and multiply. For example the issue of overseas credits and emitter/forestry arbitrage was dealt with too slowly and in an inequitable way.

**Government commitment to ETS objective** is lacking. The ETS purpose has twin objectives. One of which is to reduce NZ’s net emissions to below business-as-usual levels. We need clear signals that the Government is committed to achieving this.

<p><b>Domestic action to reduce emissions</b> has been ignored in favour of buying overseas units of dubious integrity. Forestry is an easy and cheap domestic action to reduce emissions.</p> <p><b>Complex rules</b> and ETS self-administration by forest owners can lead to non-compliance. Many small to medium sized forest owners carry out their own ETS related services and the rules are complex. Forest owners can inadvertently find themselves with carbon liabilities or penalties which can be quite large.</p> <p><b>Inadequate human resourcing</b> at MPI operations. It appears that MPI is understaffed to deal with ETS forestry operations.</p>
<p><b>F2. Do the NZ ETS forestry settings discourage deforestation? If not, what settings do you think would?</b></p>
<p><b>No-</b> Having a floating volatile carbon price means that if prices drop again then deforestation will rise. Offsetting is also a good option but the inflexibility of the design means it is very difficult to use.</p>
<p><b>F3. Do the NZ ETS settings incentivise afforestation and replanting? If not what settings do you think would?</b></p>
<p><b>No-</b> See the weaknesses in F.1. Policy and price stability is crucial.</p>
<p><b>F4. Does the NZ ETS provide effective incentives for smaller foresters to participate in the scheme? If not, what settings do you think would?</b></p>
<p><b>No-</b> See F.9 averaging. Also see F.1. comment about complexity. ETS services should be carried out by registered professionals. This would also ease MPI’s workload.</p>
<p><b>F5. Does the NZ ETS work well alongside other forestry programmes? If not, how do you think these programmes could be better aligned?</b></p>
<p><b>No-</b> Not enough support for the PFSI. The PFSI should be given more emphasis where possible as an alternative to the ETS for land and tree species that should not be harvested. The PFSI should have a special units called a ‘Permanent Forest Unit’ and emitters should be required to purchase a minimum number of PFUs per annum.</p>
<p><b>F6. What changes could be made to NZ ETS forestry sector provisions to improve the scheme?</b></p>
<p>Need policy and price certainty. A guaranteed minimum floor price of \$15/unit for ETS and \$20/unit for PFSI would provide enough security for investment into new forests, especially in areas where timber forestry is uneconomic. Part of the policy uncertainty is the current push by Government for use of international trading post 2020. This opens up potential for repeated price collapse and arbitrage opportunities.</p> <p>Pre-1990 forests should be able to participate voluntarily in earning carbon from improved forest management of the forest. This would promote better forest management practices to increase carbon storage of the pre-1990 forest estate (including native forest). It would also enable some benefits to flow to pre-1990 forests as opposed to only deforestation liabilities.</p>

### Future forestry accounting in the NZ ETS

<p><b>F7. What are important factors when considering changes to forestry accounting settings in the NZ ETS?</b></p>
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How will this impact on current participants? Will changes be voluntary or mandatory? Will the changes result in additional burdens for current or future generations?
F8. Do you think a different forestry accounting approach in the NZ ETS would change the scheme's incentives for afforestation?
<b>Yes-</b> The current instant oxidation approach to loss of carbon at harvest is a major disincentive to uptake by small to medium sized forest owners. It also raises inter-generational fairness as it delays the cost of repayment to the future. Even for ETS participants it discourages selling NZUs, and therefore can impact on market liquidity. Lastly, it may lead to unforeseen outcomes such as timber forests being locked up as permanent forests if the carbon harvest liability outweighs timber revenue.

### Averaging

F9. Do you think averaging should be introduced for post-1989 forests? If so, why? Do you think it should be optional or mandatory?
<b>Yes-</b> See reasons given in F.8. It should be optional as some owners will want to manage their own carbon liabilities and earn more credits. Also some forests may not be harvested.
F10. Should there be limits on the types of forests that can use an averaging accounting method? For example, new forests only or forests under a size threshold.
<b>No-</b> In principle all forest owners should be able to opt for averaging. However, I have some concerns about how it would be introduced and applied to existing forests given that many forests will have already exceeded the long term average carbon pools. I also have concerns about how averaging will impact supply of NZUs. Averaging would front end supply of NZUs from forestry but provide no ongoing supply (or demand) once the long term average has been reached.
F11. How might averaging impact on your business decisions?
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### Harvested Wood Products

F12. Do you think deferred liability for emissions from Harvested Wood Products (HWPs) should be recognised domestically? If so, how?
<b>Yes-</b> But in a simple and efficient manner. The benefit and liability should rest with the forest land from which the timber originated. HWP and associated decay rates should favour simplicity over accuracy. For example under instant oxidation accounting HWP could be applied in a manner similar to how post-harvest residual carbon stock is treated. If long term averaging is applied then HWP could be factored into the long term carbon stocks.
F13. How might the options for deferred liability for emissions from HWPs impact on your business decisions?
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## Other

### F14. Do you have any other comments or things you think are important?

It is unacceptable to have the threat of international units hanging over the head of the ETS for the next 5 years. Government needs to be clear as soon as possible on its intended use of overseas. If overseas units are introduced into the NZ ETS then they should be limited by quantity and quality. One possibility is having bi-lateral agreements with our pacific neighbours to develop projects in their countries that generate emission reductions that can be used in NZ. This could be in collaboration with NZ Aid, MFE, and private investors.

Auctioning of NZUs should only be carried out in a way that does not compromise or undermine effective carbon pricing. Auctioned credits must be backed up real emission reductions. For example revenue from auctioned credits could be used to purchase forest NZUs or be earmarked for emission reduction spending such as renewably energy.

An independent climate commission should be set up to ensure that the ETS is achieving its twin purposes. The commission should have the necessary powers to act quickly and independently to ensure that the ETS can adapt where necessary to maintain sufficient carbon pricing.

## NZ ETS review: Operational matters technical note

### Transfer of participation for post-1989 forestry

#### OM8. Do you think the NZ ETS transfer requirements should be changed or simplified?

I have dealt with many transfers for clients. Often ETS participants and purchasers are unaware of their obligations. I suggest that LINZ notifies MPI each time an ETS affected land transfer occurs so that MPI can then send a notice to the transferee.

Transfers and FMA participation. If a forest is measured during an emissions period and then transferred during the same emissions period the new ETS Participant should where possible be able to use the FMA participant specific table. This would reduce costs for all involved and avoid duplicating measurement.

### The public's limited access to information about the NZ ETS status of land

#### OM 14. Do you think the Government should provide information on the NZ ETS status of land that is not already subject to the NZ ETS?

Yes- there is huge uncertainty as to how land would be classified by MPI. This uncertainty can impact on investment decisions on purchasing land. If MPI has classified land as pre-1990 post-1989 then this should be available upon request.

Please let me know if you wish to follow up with any questions and if given the option I would like to speak to my submission.

Regards,



Ollie Belton