

In Confidence

Office of the Minister of Forestry

Office of the Minister of Climate Change

Cabinet Economic Development Committee

Next steps on the New Zealand Emissions Trading Scheme's permanent forest category

Proposal

- 1 This paper updates Cabinet on the progress of proposed changes to the New Zealand Emissions Trading Scheme (NZ ETS) new permanent post-1989 forest category (the permanent forest category), following consultation earlier this year.
- 2 This paper seeks Cabinet agreement on the approach and future work programme to redesign the NZ ETS permanent forest category to better support the Government's objectives for forestry, including establishing long-term indigenous carbon sinks.
- 3 This paper also seeks Cabinet's agreement not to progress the proposed changes to averaging accounting in the NZ ETS introducing a 'long rotation' category at this time.

Issue identification

- 4 Increasing carbon prices in the NZ ETS may well lead to higher-than-expected levels of permanent exotic afforestation due to the superior financial returns of this type of land use compared to traditional pastoral farming and production forestry regimes.
- 5 Left unchecked and without any management oversight or requirement as per the current NZ ETS legislation, this has the potential for significant unintended environmental and other consequences.
- 6 The Government wants to support indigenous afforestation. Permanent indigenous forests will act as long-term carbon sinks. However, indigenous forests have significantly higher establishment and maintenance costs than exotic forests. Indigenous forests are also slow growing and therefore initially sequester carbon more slowly than exotic forests.

Relation to Government priorities

- 7 This paper supports:
 - 7.1 the Government's commitments to transition to a clean, green carbon neutral New Zealand;
 - 7.2 the Government's commitments in the Emissions Reduction Plan to;
 - 7.2.1 encourage indigenous forests as long-term carbon sinks through reducing costs and improving incentives (Action 14.2); and
 - 7.2.2 develop policies that support Māori to meet their aspirations, and support Māori-led approaches to indigenous afforestation (Action 14.4.3).

Executive Summary

- 8 Forests are important to achieve New Zealand's climate change objectives.
- 9 The introduction of the permanent forest category, alongside rising carbon prices, is likely to incentivise the establishment of a large volume of permanent exotic forests. Earlier this year, we consulted on our concerns about the potential impacts of this on the environment.
- 10 This included consulting on the proposal to prevent exotic forests from registering in the NZ ETS permanent forest category, which opens on 1 January 2023.
- 11 The consultation generated significant interest – and submissions were divided on this proposal. Feedback also highlighted the significant impacts of the proposals on Māori landowners.
- 12 Following feedback and further analysis, we consider that while the design of the permanent forest category presents risks, the NZ ETS permanent forest category should remain open to all forests on 1 January 2023.

- 13 We want to support the right tree in the right location. This will help align future afforestation outcomes with the Government's forestry and climate change objectives, as well as Māori aspirations for their land. There is also an opportunity to use the permanent forest category to help reduce the barriers to indigenous afforestation. Therefore, we propose pursuing further work to develop a redesigned permanent forest category which:
 - 13.1 supports forests to deliver positive long-term outcomes as part of Aotearoa New Zealand's climate transition;
 - 13.2 supports the transition of exotic forests to long-term indigenous carbon sinks;
 - 13.3 hold forest owners accountable for delivering effective forest outcomes;
 - 13.4 ensures effective financial management of forests over the long-term;
 - 13.5 ensures forests meet environmental and other forest management best practice;
 - 13.6 manages risks to rural communities from the permanent forest category; and
 - 13.7 supports Māori to realise aspirations for their land.
- 14 The proposed changes to the permanent forestry category aim to address the long-term environmental impacts of poorly managed, or unmanaged, permanent exotic forests, as well as the impacts on rural communities, while providing an incentive to manage forests to become long-term indigenous carbon sinks.
- 15 We seek Cabinet's agreement to redesign the permanent forest category to better provide for the effective management of forests, and deliver forests which provide positive outcomes (for example, indigenous biodiversity, soil and water health, ongoing jobs and income) while contributing removals towards our emissions targets.
- 16 In particular, we propose that a redesigned permanent forest category will support forests which are managed to transition from predominantly exotics to indigenous species over time (transition forests). Transition forests, when managed appropriately, can play a role in establishing cost-effective indigenous carbon sinks.
- 17 We propose to establish a working group, comprised of Māori and other technical forestry and environmental experts, to help redesign the permanent forest category.
- 18 We tentatively consider that the redesigned permanent forest category could come into effect from 1 January 2025.
- 19 The Government also consulted on a proposal to create a 'longer rotation' averaging accounting category in the NZ ETS. This change was proposed to recognise the carbon sequestration of radiata pine grown on remote and difficult to harvest land.

- 20 We consider no changes are needed to averaging accounting for 'long rotation' radiata pine forests. We seek Cabinet's agreement not to progress the proposal to introduce a long rotation averaging accounting category for radiata pine in the NZ ETS at this time. However, further consideration of a long rotation category will be undertaken alongside work on the future design of the permanent forest category.

Background

Forestry supports New Zealand's cultural, economic and environmental well-being

- 21 Forests play a pivotal role in our cultural, economic, and environmental prosperity.
- 22 By sequestering carbon, forests help to reduce New Zealand's net emissions. To meet New Zealand's 2050 climate change targets, the Ministry for Primary Industries (MPI) projects that an increase in afforestation of between 0.74 million and 1.46 million hectares of new forest will be required.
- 23 In 2020, plantation forests provided around \$5.5 billion in annual export revenue and employed 35,000 people.
- 24 Māori have significant interests in forests as rangatira, kaitiaki, land and forest owners, workers and business owners. In 2018, Māori were estimated to own \$4.3 billion of forestry assets (six percent of the total Māori asset base) and some 2,200 Māori were employed in the sector.
- 25 The Emissions Reduction Plan sets out the long-term vision for forestry's role and contribution to New Zealand's climate change response:

By 2050, Aotearoa New Zealand has a sustainable and diverse forest estate that provides a renewable resource to support our transition to a low-emissions economy. Forestry will contribute to global efforts to address climate change and emissions reductions beyond 2050, while building sustainable communities, resilient landscapes, and a legacy for future generations to thrive.

Upcoming changes to the NZ ETS are likely to incentivise the establishment of a large volume of permanent exotic forests

- 26 The NZ ETS provides an incentive for afforestation by providing New Zealand Units (NZUs) to recognise carbon sequestration by forests.
- 27 In 2020, major reforms were made to the NZ ETS via the Climate Change (Emissions Trading Reform) Amendment Act 2020. These reforms included introducing a new permanent post-1989 forestry activity for forests that will not be clear-felled for a period of at least 50 years ('the permanent forest category'). The permanent forest category will come into force on 1 January 2023.

- 28 When introduced, the permanent forest category was intended to provide land use options that allow for permanent forest cover to support New Zealand's climate change targets¹. Currently, forests consisting of any tree species can be registered in the category (including those introduced to New Zealand such as Radiata pine – referred to as “exotic” species), and there are no limits to the total area of land that can be registered under this category.
- 29 However, Ministers have belatedly identified issues with these settings due to the high, and rising, price of carbon.
- 30 The Government consulted on proposals to change forestry settings in the NZ ETS in March and April, to manage incentives that could lead to a legacy of large areas of concentrated, poorly managed or unmanaged permanent exotic forests.
- 31 Large-scale poorly managed (or worse, unmanaged plant-and-leave) permanent exotic afforestation carries a number of risks, including:
- 31.1 Rural and local communities: Permanent exotic forests could potentially displace other productive land uses, such as farming and production forests, due to the financial returns generated from carbon in some regions. Unmanaged permanent exotic forests contribute less to employment, rural communities and GDP than other productive land uses and limit flexibility and options for future land use.
- 31.2 Long-term environmental outcomes: Permanent exotic forests made up of highly stocked and concentrated areas of pines grown to the end of their natural lifespans may have environmental issues associated with them (e.g., fire, disease, soil and conservation degradation, wilding pines). We lack empirical evidence about the potential long-term environmental and other consequences of such poorly managed or unmanaged forests, meaning that their establishment at scale presents an unknown and unacceptable degree of risk.

We proposed to prevent exotic forests from registering in the NZ ETS permanent forest category to reduce these risks

- 32 The Government sought feedback on proposed changes to the permanent forest category. Consultation asked several key questions, including:
- 32.1 Should exotic forests be prevented from registering in the permanent forest category?;
- 32.2 If so, should there be exceptions to this (allowing a smaller volume of exotic forests to register in the permanent category where these forests would support the Government's wider objectives for forestry)?

¹ Landowners may choose to plant permanent forests, rather than production forests, for a number of reasons, including economic, health and safety, or environmental factors.

- 33 The Government also proposed that any changes to the permanent forest category should be made before it opens on 1 January 2023. This was proposed to help avoid a surge of exotic forests registering in the category when it opens, creating a large permanent exotic forest legacy.

A 'long rotation' sub-category in averaging accounting for radiata pine forests

- 34 Consultation also invited views on whether to introduce a new sub-category in averaging accounting for 'long rotation' radiata pine forests, in response to concerns that averaging would under-credit some radiata pine forests which are on harvest rotations which are significantly longer than the average of 28 years. The proposed sub-category would issue radiata pine forests more carbon when the forests are planted in areas where they are not profitable to harvest at the usual ages.

Consultation feedback was divided on the proposals to prevent exotic forests registering in the permanent forest category

- 35 We received significant interest through consultation. We also spoke directly with forestry stakeholders, and Māori forestry leaders.
- 36 We heard significant variation among submitters on whether to prevent exotic forests from registering in the permanent forest category.²
- 36.1 22 percent of submitters preferred to continue the status quo (no changes to prevent exotic forests from registering in the permanent forest category);
- 36.2 36 percent favoured preventing exotic forests from registering in the permanent forest category, without any exceptions;
- 36.3 30 percent favoured preventing exotic forests from registering in the permanent forest category, with some exceptions;
- 36.4 however, 71 percent of Māori submitters opposed changes to the permanent forest category (at least on Māori land). A further 20 percent of Māori submitters supported restricting the permanent forest category, provided there were exceptions for models such as transition forests, continuous canopy production, or long-lived high-value exotic forests; and
- 36.5 almost all Māori submitters supported indigenous afforestation, with many highlighting the need for government to work in partnership with Māori on this issue.
- 37 Submitters who preferred the status quo described a need for certainty in the NZ ETS, and the importance of exotic forests to meeting our climate change targets and providing sustainable development opportunities for Māori-owned or marginal land.

² Note these figures do not add to 100%. Some submitters did not indicate their preferences, or suggested alternative options.

- 38 Submitters who favoured restricting the permanent category to indigenous forests raised concerns with large scale afforestation of farmlands, environmental impacts and social harm to communities.
- 39 Of the 30 percent of submitters who supported restricting the permanent forest category with some exceptions, the most frequently suggested exceptions were for low productivity land, erosion-prone land, long-lived exotic species and for forests transitioning from exotic forests to indigenous forests ('transition forests').

Feedback on 'long rotation' averaging accounting for radiata pine forests

- 40 A minority of submitters (29 percent) commented on the proposal to create a 'long rotation' averaging forest category. Of those who did comment, there was an even split between those who supported the proposal, those who opposed it, and those who suggested alternative long rotation options.
- 41 Those who opposed the proposal were generally sceptical the forests would be harvested and thought the proposal would introduce a strong incentive for unmanaged permanent exotic forests (exacerbating the issues that the permanent forest category proposals are seeking to address).
- 42 Māori submitters who commented on this proposal were supportive of the proposed long rotation category. Māori own a disproportionate amount of remote and marginal to harvest land which could be eligible for a long rotation category.

Submissions highlighted that Māori landowners would be particularly impacted if exotic forests are prevented from registering in the permanent forest category

- 43 Feedback highlighted the importance of this decision for Māori. Māori made strong submissions, in hui, with both Ministers and officials, and in writing, on the disproportionate impact of the proposals on their aspirations, rangatiratanga and kaitiakitanga.
- 44 Māori views were not uniform, although there was near universal agreement on the need for the permanent forest category to support certain kinds of exotic forests, and a viable indigenous afforestation programme (including a path for transition forests). Given the diversity of views from Māori, it is unlikely any decisions on these issues will be universally supported.
- 45 Whenua Māori (Māori freehold and Māori customary land) is disproportionately on remote, less versatile land (compared with general land) which makes it well suited to permanent forests. It is also held in smaller, fragmented titles, which can pose a barrier to productivity.

- 46 Many Māori submissions argued the consultation was too rushed, and almost all argued the Crown needed to take its obligation to work in partnership on the forestry proposals more seriously. Several submissions argued that the combination of the detrimental impact of the proposals and inadequate consultation was a breach of their Treaty rights.
- 47 Following the consultation period, Ministers have continued to engage with stakeholders and Māori representatives. These Māori representatives have continued to express strong concerns about the disproportionate impact that closing the permanent category to exotic forests would have on Māori, as well as the importance of partnering with Māori on any further work.

Analysis

- 48 Consultation feedback highlighted there are significant concerns to poorly managed or unmanaged permanent exotic afforestation. We share these concerns that the permanent forest category will incentivise large-scale, unmanaged permanent exotic forests to be established. This poses an unacceptable risk to rural communities and the environment. This view is consistent with concerns raised by the Climate Change Commission on permanent forestry.³
- 49 At current carbon prices, economic returns under the NZ ETS for permanent exotic forests are now significantly higher than sheep and beef farming and production forestry, the main competing land-uses. Permanent exotic forests are estimated to return a net present value of up to \$35,000 per hectare at the 2022 auction trigger price (\$70). This compares to ~\$4,500 for sheep and beef farming and ~\$25,000 for production forestry under averaging accounting.
- 50 Based on current and projected carbon prices, and the current legislative settings, MPI projects that 350,000 hectares of new permanent exotic forests could be established over this decade, equal to just over half the total afforestation that has occurred since 1990.⁴
- 51 The permanent forest category does, however, represent opportunities to support the government's forestry objectives around climate change and the environment, and to support Māori to realise aspirations for their land.
- 52 The Climate Change Commission recommended greater investment in new and regenerating indigenous forests to deliver a long-term carbon sink to offset emissions that are hard to reduce.⁵ However, indigenous forests are slow growing and therefore their ability to sequester carbon is lower in the early years of establishment relative to exotic forests. Indigenous forests also have significantly higher establishment and maintenance costs than exotic forests.

³ Climate Change Commission (2021) *Ināia tonu nei: a low emissions future for Aotearoa*.

⁴ There is currently 9.6 million hectares of sheep and beef farm land in New Zealand. (Beef + Lamb New Zealand (2021) *Compendium of New Zealand Farm Facts 2021*).

⁵ [Ināia tonu nei: a low emissions future for Aotearoa \(May 2021\) Climate Change Commission](#)

- 53 The originally proposed changes to the permanent forest category are likely to have very little direct effect on native afforestation, as they will not address these barriers. Due to indigenous forests' initially slow sequestration and high costs, they provide economic returns between -\$8,000 and \$1,500 per hectare⁶. This is far lower than the returns from permanent exotic forests (up to \$35,000 per hectare) and other land uses like sheep and beef farming (~\$4,500 per hectare).
- 54 Transition forests comprising exotic species, when managed appropriately, can play a role in establishing cost-effective long-term indigenous carbon sinks.
- 55 We also consider the permanent forest category, when appropriately managed and with sufficient oversight, has the potential to deliver forests which provide positive outcomes (for example, indigenous biodiversity, soil and water health, ongoing jobs and income) while contributing towards our net emissions climate change targets.

Proposal

There is, therefore, an opportunity to redesign the permanent forest category

- 56 We propose to progress further work to redesign the permanent forest category to support better outcomes for the environment, local communities, and our climate change objectives, and provides a financially viable mechanism to support forest models that transition from predominantly exotic to predominantly indigenous forests over time.
- 57 In the meantime, we propose the permanent forest category opens without changes on 1 January 2023, as currently legislated.
- 58 We intend the redesigned permanent forest category to be available by 1 January 2025.

⁶ Net present value calculated using a \$70 carbon price, and an 8% discount rate over a 50 year term. Net present value is a calculation of investment returns, often used to compare decisions based on future revenue streams and costs.

Objectives of a redesigned permanent forest category

- 59 We seek Cabinet's endorsement to develop a redesigned permanent forest category with the following objectives:
- 59.1 support forests to deliver positive long-term outcomes as part of Aotearoa New Zealand's climate transition;
 - 59.2 supports the transition of exotic forests to long-term indigenous carbon sinks;
 - 59.3 hold forest owners accountable for delivering effective forest outcomes;
 - 59.4 ensure effective financial management of forests over the long-term;
 - 59.5 ensure forests meet environmental and other forest management best practice;
 - 59.6 manage risks to rural communities from the permanent forest category; and
 - 59.7 support Māori to realise aspirations for their land.

60 9(2)(f)(iv) [REDACTED]
[REDACTED]
[REDACTED] The redesigned permanent forestry category will aim to address the long-term environmental impacts of poorly managed, or unmanaged, permanent exotic forests as well as the impacts on rural communities. We consider that other risks created by increased permanent exotic afforestation are being addressed through a broader package of forestry policy proposals (Appendix One outlines the broader package).

61 The Government has also agreed to amend the National Environmental Standards for Plantation Forestry (NES-PF) to include permanent exotic forests, and to consult on options to allow for local discretion on the location of new afforestation, based on socio-economic and environmental grounds [CAB-22-MIN-0041]. This work will help manage the impacts of permanent exotic forests on the environment and rural communities. A discussion document will be shortly submitted for Cabinet consideration.

We will consider several design elements to achieve these objectives

We will consider the types of forest models which will support these objectives

62 Submitters have put forward several forestry models which would support multiple government objectives, in particular, transition forests. Submitters highlighted these could help support efforts to develop indigenous forests as long-term carbon sinks.

63 A permanent forest category could also have scope to recognise other novel forestry management approaches, or species, over time (such as redwoods) if they support the Government's forestry objectives in the future.

We will consider what forest management requirements could support the redesigned permanent forest category

- 64 A redesigned permanent forest category would have forest management regime requirements to ensure environmental and other risks are managed appropriately.
- 65 The details of an appropriate forest management regime will be developed and tested through the next phase of work.
- 66 This could include exploring ideas suggested during consultation; such as requiring bonds, or fire management requirements.

We propose to work together with Māori and other technical forestry experts to redesign the permanent forest category

- 67 Any changes to the permanent forest category will have significant impacts on the forestry sector and Māori landowners.
- 68 Therefore, we seek Cabinet's approval to work with Māori and other technical forestry experts when progressing the redesign of the permanent forest category.
- 69 The Minister of Climate Change and the Minister of Forestry will be jointly accountable for this work.

Working group

- 70 We consider a working group, including Māori and other technical forestry and environmental experts, is the most effective way to progress work to redesign the permanent forest category.
- 71 The working group will include strong Māori representation, given the significance of this work for Māori, and the Government's commitments to develop forestry policies that support Māori to meet their aspirations. We propose to invite the National Iwi Chairs Forum, Federation of Māori Authorities, and Māori forestry leaders to nominate experts to the working group.
- 72 As lead Ministers, we will agree the terms of reference for the working group, with the scope of their role, and timeframes, clearly defined.
- 73 We also acknowledge that no group will be able to represent the diverse suite of perspectives and interests in this area. Further public consultation, particularly with Māori, will be important before amending the permanent forest category.

Timeline

- 74 We consider that redesigned permanent forest category could come into effect from 1 January 2025. The sooner this work can be completed, the sooner the Government can provide regulatory certainty for landowners, foresters and Māori, and the smaller the impact of permanent exotic forests registering in the NZ ETS in the interim.
- 75 The working group will complete the majority of its work by the end of 2022. We will return to Cabinet seeking agreement to consult on a redesigned permanent forest category around March 2023. We intend to return to Cabinet seeking final policy decisions before June 2023.

We accept that there are risks associated with leaving the category open on 1 January 2023 while the permanent forest category is redesigned

- 76 We acknowledge there are risks to the permanent forest category opening on 1 January 2023 as currently legislated, while further work progresses. During this interim period, the permanent forest category may incentivise a large area of new exotic afforestation to occur – which carries a short-term risk of displacing productive farmland.
- 77 We explored other options, including preventing exotic forests from registering in the permanent forest category while redesigning the category. However, we consider there are significant constraints to this, including:
- 77.1 the short timeframe to implement this option. Given the high level of public interest, there must be time for appropriate consultation during the legislative process;
 - 77.2 temporarily closing the category would create significant uncertainty for stakeholders around the future design of the category; and
 - 77.3 the high bar, and time needed, to amend or create environmental regulations in New Zealand.
- 78 In order to mitigate this risk, we propose to clearly signal now our intention to revise the permanent forest category in the near future. The proposed consultation on the NES-PF during September/October 2022 will also indicate the Government's intention to better manage the impacts of permanent forestry.
- 79 An important part of the work on the redesigned category, will be determining how any future forest management requirements could also apply to those forests which enter the permanent forest category during the interim period (potentially from 1 January 2023 to 31 December 2024).

No changes are needed to averaging accounting for 'long rotation' radiata pine forests at this time

- 80 The Government also consulted on a proposal to create a 'longer rotation' averaging accounting category to recognise the carbon sequestration of radiata pine grown on remote and difficult to harvest land.

- 81 Following consultation and further analysis, we consider that no changes are needed to average accounting at this time.
- 82 A long rotation averaging category could increase potential economic returns for on remote and marginal to harvest land by an estimated 20 to 25 percent over existing NZ ETS settings. However, financial returns from the existing NZ ETS averaging accounting settings significantly increase the profitability of production forests on all classes of land and significantly exceed returns from alternative land uses.
- 83 There are also risks identified with a long rotation averaging category. The category could misalign the units awarded by the NZ ETS with those recognised towards New Zealand's international climate commitments (the Nationally Determined Contribution). Additionally, other production forestry species such as redwoods or Douglas fir (which have longer averaging periods) that are already provided for in the NZ ETS may be better suited to remote or marginal to harvest land.
- 84 During consultation, some submitters expressed doubts that log volumes and value will increase as the forest ages to make harvesting financially viable. Therefore, there is uncertainty around whether these forests will be harvested, and this could exacerbate many of the issues associated with permanent exotic forests that the proposed changes to the permanent forest category are intending to address.
- 85 We recommend that further consideration of a long rotation category for remote and marginal to harvest land be undertaken alongside work on the future design of the permanent forest category.

Financial Implications

- 86 The proposals in this paper do not create any financial implications for the Government.

Legislative Implications

- 87 Subject to further policy development and consultation, we expect to return to Cabinet no later than June 2023, to seek agreement to amend the Climate Change Response Act 2002 to provide for the modified permanent forest category and any associated changes to the NZ ETS.

Risks of the permanent forest category opening on 1 January 2023 without change

- 88 Ongoing work will need to consider the risks that forests entering the permanent forest category from 1 January 2023 may not be able to comply with future changes to the permanent forest category (such as any conditions imposed through management plans). The Legislation Design and Advisory Committee guidelines set out best practice for new legislation, and advise that new legislation should respect property rights and not have retrospective effect.
- 89 Participants who choose to enter the permanent forest category from 1 January 2023 will have a strong interest in how future regulatory changes will impact on their investment decisions which will likely result in heightened scrutiny of future legislative changes.

9(2)(h)

Impact Analysis

Regulatory Impact Statement

- 92 A regulatory impact statement has been prepared, and is attached (Appendix Two).
- 93 A joint Ministry for the Environment – Ministry for Primary Industries Regulatory Impact Analysis Panel has reviewed this regulatory impact statement “Managing permanent exotic afforestation incentives”. The Panel considers that the regulatory impact statement meets the quality assurance criteria.
- 94 A further regulatory impact statement will be presented to Cabinet following further work to redesign the permanent forest category.

Climate Implications of Policy Assessment

- 95 A completed Climate Implications of Policy Assessment: Disclosure Sheet is attached to this Cabinet paper (Appendix Three).

Population Implications

96 The opening of the NZ ETS permanent forestry category to all forests on 1 January 2023 has no additional population implications. The Government will consider the population implications of any proposed changes resulting from the work to redesign the permanent forest category when we return to Cabinet seeking final policy decisions.

Te Tiriti o Waitangi implications

97 Both the Crown and Māori have positive duty to act in good faith, fairly, reasonably and honourably towards each other. The duty of good faith includes a requirement that the Crown take reasonable steps to make informed decisions on matters that affect Māori interests.

98 Changes to the permanent forest category may have a disproportionate impact on Māori landowners. In coming to its final proposals, the Crown will need to weigh up a variety of considerations including environmental, economic, social as well as the impact on Māori.

99 The Crown is also mindful of the commitments made in the Emissions Reduction Plan to partner with Māori in developing forestry policies that support Māori aspirations, and their exercise of kaitiakitanga and rangatiratanga.

100 We are proposing to carry out further work with Māori, and other technical forestry and environmental experts, to redesign the permanent forest category. The redesigned permanent forest category will provide better opportunities to Māori than the proposal to prevent exotic forests registering in the permanent forest category – provided it is designed in a way that meets Māori needs.

Human Rights

101 This paper has no human rights implications.

Consultation

Public consultation

102 The Government published the discussion document containing proposals to change forestry settings in the New Zealand Emissions Trading Scheme on 3 March. Formal consultation ran from 14 March to 22 April. Officials ran three open webinars during this time (face-to-face consultation was limited by Covid restrictions). One webinar was specifically targeted to Māori.

103 Ministers have received feedback on these proposals at several meetings with key stakeholders and Māori organisations, including Māori forestry leaders.

104 Going forward, we propose to work with Māori and other technical forestry and environmental experts to redesign the permanent forest category. Further public consultation is likely to be required (provisionally occurring in early 2023), before the permanent forest category is eventually amended.

Agency consultation

105 The following agencies have been consulted: Ministry of Business, Innovation and Employment; Department of Conservation; Ministry of Foreign Affairs and Trade, Office for Māori Crown Relations – Te Arawhiti; Te Puni Kōkiri; and The Treasury, and their comments have been considered. The Department of the Prime Minister and Cabinet has been informed.

The Department of Conservation (DOC) Agency comment

106 DOC has raised concerns that leaving the permanent forest category open to exotic forests will lead to large-scale permanent exotic afforestation and create significant negative environmental, economic and social impacts.

107 DOC's preference is to institute a moratorium on entering exotic forests in the permanent category, potentially with an exception for Māori land. In the alternative, DOC would support the creation of a separate category for permanent native forests to enable a price premium to develop for NZUs that provide both biodiversity and climate benefits.

108 DOC considers that any further work on the permanent forest category should focus primarily on incentivising the restoration of native forests, as opposed to transition forests as currently proposed. The potential for exotic forests to transition to indigenous species over time is not well established, and the overall viability of this approach requires significant further investigation.

Green Party comment

109 The Green Party was consulted on this paper under the Co-operation Agreement between the Labour and Green Parties, and provided comments.

110 The Green Party opposes retrospective application of future regulations to new permanent exotic forests. If a moratorium (preventing exotic forests registering in the permanent forest category) is not favoured, then as an interim, the Green Party instead seeks that the current National Environmental Standards for Plantation Forestry (NES-PF) apply from 1 January 2023. This would ensure there is no regulatory gap for forestry activities commencing next year, and would provide better environmental standards and a predictable operating environment for landowners and the forestry sector.

- 111 The Green Party notes that substantive review of the NES-PF should be done as soon as possible, to ensure future regulatory standards are fit for purpose for an increase in exotic afforestation, with particular regard to fire risk, soil quality, impacts of exotic forestry on biodiversity and landscape values, reduction of stream flows, weed management and exacerbation of natural hazards and flooding risk from poor forest management.
- 112 The Green Party also notes the importance of related work on NZ ETS supply settings proceeding at pace. The Green Party believes it is essential to ensure NZ ETS settings facilitate cuts in gross emissions, with credits from forestry incentivising additional sequestration rather than unlimited offsets for avoidable pollution.
- 113 The Green Party also seeks more support and development of incentives to increase the sequestration of indigenous forests (including pre-1990 indigenous forests) including enhancing biodiversity values through pest control.
- 114 The Green Party seek clarity and detail on the proposed criteria and land management regime for 'transition forests' and for this to be determined before opening the permanent forest category to all forests. It notes there is no large scale precedent for using pine or other fast growing exotic species as a step towards indigenous afforestation in Aotearoa.
- 115 The Green Party recognises the Tiriti issues and particular impact on Māori landowners, and notes the importance of continuing to engage with Māori, and in particular, supporting iwi and hapū to achieve their aspiration for indigenous reforestation.

Communications

- 116 Ministers will announce Cabinet's decision via a joint press release following Cabinet.

Proactive Release

- 117 We intend to proactively release this paper on the Ministry for the Environment's website, subject to redactions as appropriate equivalent to those under the Official Information Act 1982, once public announcements have been made.

Recommendations

The Minister of Forestry and the Minister of Climate Change recommend that the Committee:

Background

- 1 **Note** that forests are important to achieving New Zealand's climate change objectives.
- 2 **Note** that the NZ ETS provides an incentive for afforestation by providing NZUs to recognise carbon sequestration by forests.
- 3 **Note** that a new NZ ETS permanent forest category (for forests that will not be clear-felled for a period of at least 50 years) was introduced by the Climate Change (Emissions Trading Reform) Amendment Act in 2020 and is scheduled to open for registrations from 1 January 2023.

Problem

- 4 **Note** that current NZ ETS settings and carbon prices, and the expectation of rising carbon prices in future, will potentially lead to increasing levels of permanent exotic afforestation.
- 5 **Note** that poorly managed or unmanaged permanent exotic afforestation has the potential to create a number of risks, including the displacement of productive land uses and environmental risks.
- 6 **Note** the proposals in this paper are one part of a broader package of work to manage these issues.

Consultation

- 7 **Note** the Government consulted on proposals to change forestry settings in the NZ ETS in March and April 2022, to mitigate the risk of widespread poorly managed or unmanaged permanent exotic afforestation, including:
 - 7.1 proposals to prevent exotic forests from registering in the permanent forest category; and
 - 7.2 proposals to create a 'longer rotation' averaging forest category to recognise the carbon sequestration of radiata pine grown on remote and difficult to harvest land.
- 8 **Note** that these proposals have significant impacts on Māori.

Analysis

- 9 **Note** that the carbon price has doubled within a short timeframe, from around \$35 in late 2020 to \$75 in mid-2022, and the price is expected to increase further over time.

- 10 **Note** that we continue to have concerns that the permanent forest category will incentivise the establishment of large-scale poorly managed or unmanaged permanent exotic forests posing risks to rural communities and the environment.
- 11 **Note** native afforestation is uneconomic due to slow growth and sequestration rates, and high establishment and management costs.
- 12 **Note** that following consultation we consider that, while the permanent forest category presents risks, it also presents opportunities to support the Government's forestry and climate change objectives, and Māori aspirations for their land – and further analysis is needed to balance these trade-offs.

Proposal

- 13 **Confirm** that the NZ ETS permanent forestry category will open to all forests on 1 January 2023, as currently legislated.
- 14 **Agree** to the Minister of Forestry and the Minister of Climate Change carrying out further work to redesign the permanent forest category.
- 15 **Note** we intend to amend the permanent forestry category in the future, and we tentatively consider that redesigned permanent forest category could come into effect from 1 January 2025.
- 16 **Note** we envisage a redesigned NZ ETS permanent forest category will:
 - 16.1 Support forests to deliver positive long-term outcomes as part of Aotearoa New Zealand's climate transition.
 - 16.2 Supports the transition of exotic forests to long-term indigenous carbon sinks.
 - 16.3 Hold forest owners accountable for delivering effective forest outcomes.
 - 16.4 Ensure effective financial management of forests over the long-term.
 - 16.5 Ensure forests meet environmental and other forest management best practice.
 - 16.6 Manage risks to rural communities from the permanent forest category.
 - 16.7 Support Māori to realise aspirations for their land.
- 17 **Note** we consider that transition forests, when managed appropriately, could play a role in establishing cost-effective indigenous carbon sinks.
- 18 **Note** that the proposed changes to the permanent forestry category predominantly aim to address the long-term environmental impacts of poorly managed, or unmanaged, permanent exotic forests as well as the impacts on rural communities.

Proposals to adjust averaging accounting for 'long rotation' radiata pine forests

- 19 **Confirm** that no changes be made to average accounting for 'long rotation' radiata pine forests at this time.

Next steps

- 20 **Note** that accountability for this work programme be held jointly between the Minister of Forestry and the Minister of Climate Change.
- 21 **Note** that we propose to undertake further work by developing a working group, including Māori and other technical forestry and environmental experts, to redesign the permanent forest category.
- 22 **Agree** to announce the Government's intent now to reduce regulatory uncertainty.

Proactive release

- 23 **Agree** to proactively release this paper on the Ministry for the Environment's website, subject to redactions as appropriate equivalent to those under the Official Information Act 1982, once public announcements have been made.

Authorised for lodgement

Hon Stuart Nash

Minister of Forestry

Hon James Shaw

Minister of Climate Change

Appendix 1: Current and upcoming initiatives supporting the Government's forestry and climate change goals (related to this paper)

9(2)(f)(iv)

Proactive release

9(2)(f)(iv)

Climate Implications of Policy Assessment: Disclosure Sheet

This disclosure sheet provides the responsible department's best estimate of the greenhouse gas emissions impacts for New Zealand that would arise from the implementation of the policy proposal or option described below. It has been prepared to help inform Cabinet decisions about this proposal. It is broken down by periods that align with New Zealand's future emissions budgets.

Section 1: General information

General information	
Name/title of policy proposal or policy option:	Managing Permanent Exotic Afforestation Incentives
Agency responsible for the Cabinet paper:	Ministry for Primary Industries/ Ministry for the Environment
Date CIPA finalised:	15 August 2022
Short description of the policy proposal:	<p>Current ETS settings, NZU prices and the expectation of increasing NZU prices in future, are driving increasing levels of afforestation, particularly permanent exotic afforestation (because these forests remove the most carbon, fastest). This permanent exotic afforestation is causing three concerns:</p> <ol style="list-style-type: none"> 1. The increasing financial attractiveness of permanent exotic forests may cause the displacement of farming and production forests (with their associated jobs and contributions to GDP). 2. High levels of permanent exotic forests entering the ETS will erode the Crown's ability to effectively manage ETS supply in a stable and enduring way. 3. Permanent exotic forests made up of highly stocked and concentrated areas of pines grown to the end of their natural lifespans may have environmental issues associated with them. <p>To manage these risks, the Government proposes to restrict the permanent forest category in the ETS to indigenous forests once an exceptions' regime for exotic forests is developed. An exceptions' regime for exotic forests that provide wider benefits is expected to be developed by 2025. More information can be found in the Regulatory Impact Statement: Managing Exotic Afforestation Incentives.</p>

Section 2: Greenhouse gas emission impacts

Contribution of forestry towards forestry emissions budgets under the range of policy scenarios (Mt CO₂-e)

Sector & source	Greenhouse gas emissions in thousand tonnes of carbon dioxide equivalent (Mt CO ₂ -e)						Cumulative impact (2022-2035)
	2022–25	2026–30	2031–35	2036–40	2041–45	2046–50	
Forestry sector sub-targets ¹	26.4	57.2	81.6	N/A*	N/A*	N/A*	165.2
Estimated forestry removals without permanent exotic forests restricted in the ETS (status quo) (central estimates)	24.2	55.8	119.1	N/A*	N/A*	N/A*	199.1
Estimated forestry removals with permanent exotic forests restricted in the ETS from 2025 once exemptions are developed (central estimates)	24.4	55.7	85.4	N/A*	N/A*	N/A*	165.5
Impact of restricting permanent exotic forests in the ETS (central estimates) (negative = decrease in emissions, positive = increase in emissions)	-0.2	0.1	33.7	N/A*	N/A*	N/A*	-33.6

* Sector sub-targets only set for first three emissions budgets. Estimates beyond 2035 not provided at this stage. Note range of estimated impact grows substantially looking further into the future (there is generally a high level of uncertainty predicting forestry activity). Estimates include the contribution from the three CERF budget bids, increasing woody biomass supply, native afforestation and maximising carbon storage.

Section 3: Additional information

Additional information

Current ETS settings, NZU prices and the expectation of increasing NZU prices in future, are driving increasing levels of afforestation, particularly permanent exotic afforestation (because these forests remove the most carbon, fastest). This permanent exotic afforestation is causing three concerns:

1. The increasing financial attractiveness of permanent exotic forests may cause the displacement of farming and production forests (with their associated jobs and contributions to GDP).
2. High levels of permanent exotic forests entering the ETS will erode the Crown's ability to effectively manage ETS supply in a stable and enduring way.
3. Permanent exotic forests made up of highly stocked and concentrated areas of pines grown to the end of their natural lifespans may have environmental issues associated with them.

¹ <https://environment.govt.nz/assets/publications/Aotearoa-New-Zealands-first-emissions-reduction-plan.pdf>

Additional information

To manage these risks the Government proposes to restrict the permanent forest category in the ETS to indigenous forests once an exceptions' regime for exotic forests is developed. An exceptions' regime for exotic forests that provide wider benefits is expected to be developed by 2025. Based on externally commissioned research and analysis, MPI's projections show that limiting permanent exotic forests in the ETS will not affect forestry removals for New Zealand's first and second emissions budget periods. This is because these removals will largely come from existing forests and afforestation rates are estimated to be the same up until the category is limited to exotic forests in 2025. Restricting permanent exotic forests in the ETS is estimated to significantly reduce forestry removals for the third budget period, although this is still estimated to exceed the forestry sub-sector target for this period by 4 Mt CO₂-e. Over the first few years of introducing a restriction on permanent exotic afforestation forestry removals will slightly improve due to reduced losses from vegetation and soils associated with the first few years following afforestation.

This policy change is also estimated to have no impact forestry removals towards the 2030 Nationally Determined Contribution (NDC).

While this proposal has been modelled to increase New Zealand's net emissions beyond 2030 (relative to the status quo), it would potentially lead to greater levels of gross emissions reductions by reducing the volume of units available to offset the emissions from industry and non-forest sectors at low cost. This would maintain the Crown's ability to effectively manage ETS supply in a stable and enduring way to support gross emissions reductions in non-forest sectors.

The ERP is the Government's response to the Climate Change Commission's (the Commission) advice for meeting emissions budgets. The ERP has agreed to prioritise gross emissions reductions, while maintaining support for net emissions, and to consider the design and role of the NZ ETS with respect to these objectives. These decisions were made in response to the Commission's recommendations to strengthen the incentive for gross emissions reductions and manage the amount of exotic forest planting that the NZ ETS drives.

The Commission's recommendations were premised on similar risks to those identified by the Government in its consultation on proposals to manage exotic afforestation incentives. The Commission identified that the current NZ ETS settings will drive the relatively low-cost abatement option of exotic forests, rather than more costly gross emissions reductions that put Aotearoa on a sustainable path to net zero over the long term.

It is difficult to predict the amount of new forest that may be established in response to any restrictions to permanent exotic forests. Long-term forestry projections are uncertain, and the trajectory of NZU price is variable.

Section 4: Summary and Quality assurance

Summary of climate implications and quality assurance

The Climate Implications of Policy (CIPA) team has been consulted and confirms that the CIPA requirements apply to the proposal to limit permanent exotic afforestation as the potential impact on net emissions is significant. Limiting permanent exotic afforestation is expected to significantly reduce the levels of afforestation and ETS unit supply into the market from forestry.

Under the proposal to introduce limits in 2025, there is expected to be very little impact on emissions over the first two emissions budget periods. Existing forests and projected forestry activity alongside quantified non-ETS forestry initiatives are estimated to result in 24.4 Mt CO₂-e of removals in the first emissions budget and 55.7 Mt CO₂-e in the second emissions budget period. In the third emissions budget the restrictions are estimated to reduce removals by 33.7 Mt CO₂-e due to reduced afforestation.

Over the first few years of introducing a restriction on permanent exotic afforestation forestry removals will slightly improve due to reduced losses from vegetation and soils associated with the first few years following afforestation.

Summary of climate implications and quality assurance

The actual impact of the restrictions is highly dependent on the ETS price, other non-ETS forestry initiatives, forester decision-making, and the design of the exceptions' regime.

While the proposal to restrict permanent exotic afforestation has been modelled to increase New Zealand's net emissions over the medium to long-term (relative to the status quo), it would potentially lead to greater levels of gross emissions reductions by reducing the volume of units available to offset the emissions from industry and non-forest sectors at low cost. This would drive a relatively higher emissions price contributing to gross emissions reductions in non-forest sectors.

Policies and measures to incentivise indigenous afforestation that were outlined in the emissions reduction plan are not included in the estimates. These are likely to increase removals once they are developed.

The CIPA team has reviewed the estimated emissions impacts and considers them to be reasonable as best-estimates, given the high level of uncertainty in predicting long-term forestry activity.

Appendix A: Assumptions

Forest type	Lower Removals (\$117 by 2050)	Central (\$200 by 2050)	Upper Removals (\$270 by 2050)
Exotic afforestation	Assumes the lowest carbon price pathway as recommended by the CCC.	Assumes midpoint carbon price pathway as recommended by the CCC.	Assumes the highest carbon price pathway as recommended by the CCC
Native forest afforestation	Assumes the lowest carbon price as recommended by the CCC. Native afforestation increasing to 12,500 ha/year per year by 2050.	Assumes the mid carbon price as recommended by the CCC. Native afforestation increasing to 20,000 ha/year by 2050.	Assumes the mid carbon price as recommended by the CCC. Native afforestation increasing to 28,000 ha/year by 2050.
Deforestation	As per June 2021 Government projections upper deforestation scenario	As per June 2021 Government projections central deforestation scenario	As per June 2021 Government projections lower deforestation scenario