

Consultation response:

Review of the NZ ETS and redesign of the permanent forest category

By:

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Background

The Centre for Sustainable Finance: Toitū Tahua (CSF) advances progress toward the [Sustainable Finance Forum's 2030 Roadmap for Action \(the Roadmap\)](#), published in 2020. The Roadmap highlights key recommendations to achieve an equitable, sustainable, and inclusive financial system in Aotearoa New Zealand. The New Zealand Emissions Trading Scheme is an important financial lever, to send price signals to producers, consumers and investors, and to promote sustainable outcomes in New Zealand. Currently, the NZ ETS falls short in driving significant reductions in gross emissions. This was caused by a noticeable increase in forestry investments and speculative holding of units, which then led to lower prices. The cooling of prices was largely driven by government intervention and increased political uncertainty.

The options put forward in the Ministry for the Environment's (MfE, **the Ministry**) NZ ETS Review Consultation document seeks to propose and encourage public discussion and input into a range of outcomes of the NZ ETS.

Recommendation #7 "Value" of the Roadmap highlights five focus areas underpinning CSF's position on impacts arising from the review of the NZ ETS.¹ These focus areas include to;

1. Engage in a broad conversation of the idea of value
2. Introduce market mechanisms and fiscal incentives to internalise environmental and social outcomes
3. Broaden financial regulation to integrate and encourage positive environmental and social outcomes
4. Account for environmental and social outcomes
5. Government procurement to include positive environmental and social outcomes.

CSF's position also considers our focus on creating equitable outcomes for New Zealanders, as the consultation regarding the NZ ETS review carries implications that will impact equitable outcomes.

Recent consultation with market participants has highlighted the importance of the NZ ETS as a price mechanism to address gross emissions reductions in particular. The other key takeaway from this consultation was a desire to see a biodiversity market or credit system, as environmental and social co-benefits were highlighted as being of significant importance to members.

Summary of response

Taking into account the current state of the NZ ETS, the importance on valuing long term environmental and social impacts, and the feedback of our partners and stakeholders, we encourage the Government to pursue its proposed reform of the NZ ETS, including the redesign of the permanent forest category.

Broadening the idea of value has implications for the NZ ETS, especially when considering the potential changes posed by the review. A wider view of value requires a shift towards consideration of not only financial gains, but also intergenerational social and environmental impacts. This would move towards the fostering of a more resilient, responsible, and inclusive society that considers the well-being of both present and future generations, while safeguarding the environment.

¹ [Sustainable Finance Forum Roadmap for Action](#)



Our submission response:

High-level direction across both consultations

- Delivering a just and equitable transition will require a “whole-of-system” change for our economy and society and decisions about the NZ ETS are critical to achieving these outcomes.
- Gross emission reductions and forestry removals should not be traded off against each other on an equal basis as they provide different environmental, economic and social value.

The role of the NZ ETS to achieve gross emissions reductions

- Substantial reductions in gross emissions are required in the coming decade in order to meet national targets, international obligations and global temperature goals.
- A strong emissions price signal for gross emission reductions is required to help deliver the scale of reductions required.

The role of the NZ ETS to incentivise forestry removals

- Forestry removals may have different roles in the short-, medium- and long-term.
- Forestry removals have a broader environmental role to play than just in climate change mitigation; including by helping to achieve biodiversity, regional economic and social and equity outcomes.

Considerations for use of additional policy levers, besides the NZ ETS

- The NZ ETS should be operated as part of a broader policy portfolio and so it doesn't need to be designed to achieve all of the outcomes required by itself
- Endogenous factors such as the disproportionate impacts on underserved populations and reliance on monocultured exotic species should be considered
- A broader scope of removal actions, for example incentivising wetland restoration, holds the potential to incentivise increased removal activities while discouraging land uses that contribute to emissions from such sources.

Our position on the proposed options in the NZ ETS Review Consultation document is that a reform of the NZ ETS can help to clarify the role that the NZ ETS has in supporting clean investment in New Zealand.

We believe that options 1 and 2 do not provide clear enough outcomes for the NZ ETS, nor do they strive for enough meaningful change.

We believe options 3 and 4 can deliver on similar outcomes if implemented correctly. Not enough information has been provided for CSF to differentiate between these two options, as a range of factors, such as the scale of forestry differentiation and the importance of co-benefits to consumers, need to be known in order to make informed decisions.

Any transition to a reformed NZ ETS needs to take into consideration the impact of changes to existing market participants and investors which committed capital under the previous market settings. In addition, the process of transitioning the ETS to a new structure, over and above the impact of the new policy settings in and of themselves, could create uncertainty for the time it takes to establish the new settings. Prolonged uncertainty could threaten market confidence and credibility which may lead to unintended consequences, such as key intermediaries exiting the market. Therefore a careful transition plan needs to be put in place to avoid both the process of reforming the ETS and the new ETS settings themselves negating the intended outcomes of the review.



It is our view that the Ministry should provide further detailed analysis on options 3 and 4 before progressing with implementation.

Submission

Consultation Questions relevant to CSF, as set out in NZ ETS Review document

Question Number	Consultation Question
3.1	Do you agree with the case for driving gross emissions reductions through the NZ ETS? Costs of emissions reductions?
3.2	Do you agree with assessment of the cost impacts of a higher emissions price?
3.3	How important do you think it is that we maintain incentives for removals?
4.4	What opportunities for Māori do you see in the NZ ETS review and redesign of the permanent forest category?
5.1	Should the Government's primary objective for the NZ ETS review be to consider whether to prioritise gross emissions reductions in the NZ ETS while maintaining support for removals?
5.2	Should the NZ ETS support more gross emissions reductions by incentivising the uptake of low-emissions technology, energy efficiency measures, and other abatement opportunities as quickly as real-world supply constraints allow?
5.3	Should the NZ ETS drive levels of emissions removals that are sufficient to help meet Aotearoa New Zealand's climate change goals in the short to medium term and provide a sink for hard-to-abate emissions in the longer term?
5.4	Do you agree with primary assessment criteria and key considerations used to assess options in the consultation?
6.1	Which option aligns the best with the primary objectives to prioritise gross emission reductions while maintaining support for removals?
6.3	Of the four options proposed, which do you prefer?
6.4	Are there any additional options that you believe the review should consider?
6.5	Based on your preferred option(s), what other policies are required to manage any impacts of the proposal?
7.1	Should the incentives in the NZ ETS be changed to prioritise removals with environmental co-benefits such as indigenous afforestation?
7.2	If the NZ ETS is used to support wider co-benefits, which option do you think would provide the greatest opportunity to support this?
7.4	What other mechanisms do you consider could be effective in rewarding co-benefits or recognising other sources of removals?

High-level perspective – our messages that sit across both consultations

Our high-level messages:

- **Delivering a just and equitable transition will require a “whole-of-system” change for our economy and society.**
- **Gross emission reductions and forestry removals should not be traded off against each other on an equal basis.**

Our view of the policy choices available:

- **Delivering a just and equitable low-carbon transition will require a diverse set of policy tools.**
- **Emissions pricing is a vital policy tool because it can send a signal for change into thousands of day-to-day and capital investment decisions.**



The primary objective of the NZ ETS should be to incentivise emitters to reduce their gross emissions to avoid incurring the cost of abatement. In-principle, the NZ ETS should reduce gross emissions over time as heavy emitters transition to less intensive means of production, driven by an increasing New Zealand Unit (NZU) price and a gradual reduction in the availability of units over time.

In reality, an increasing NZU price has attracted large-scale forestry investment into the market, contributing to an oversupply of NZUs. Recently, we have seen the NZU price reflect a crisis of confidence in the market, as unclear price signalling has caused volatility in the market.

For the NZ ETS market to function, gross emissions reductions and forestry removals should not be treated or traded off against each other on a one-to-one basis. In order to avoid this trade off and increase the effectiveness of the market, a reform of the NZ ETS is supported by CSF.

We acknowledge there will be a range of stakeholders that will be impacted by the proposed changes to the NZ ETS, including:

- Māori and landowners with marginal land, who tend to hold significant interests in forestry outcomes.
- Domestic and international investors into New Zealand forestry
- The holders of NZUs already in private accounts
- New Zealand households and the economy as a whole; the NZ ETS will have flow-on pricing effects to goods and services. This could be felt by households through an increase in the cost of living.

It is worth noting that these changes will not only be felt in the short-term with a potentially increased cost of living, but generations to come will live with the outcomes of decisions made today.

To deliver a just and equitable transition in line with our Roadmap strategy, a whole-of-system change will be required. The NZ ETS is a key pricing signal the Government can use to signal this. It has the ability to influence thousands of day-to-day expenditures and large capital investment decisions, which means price signalling in this market has widespread domestic implications. The transition should also include the use of a range of policy levers not just concentrated on the NZ ETS market.

Relevant NZ ETS Consultation questions: 3.1, 3.2, 4.4, 5.4.



Four options proposed by the Ministry for the Environment

Currently, the price of carbon is not high enough to drive significant decarbonisation changes in the energy, transport and waste sectors. The Government is proposing four options if decisions are made to change the NZ ETS design.

Option 1

Decrease the amount of emissions units so that the carbon price rises

In the short-term this would incentivise polluters to reduce emissions faster and landowners to plant more trees. In the long-term with more removals from activities like forestry the price of carbon would be likely to drop.

Option 2

Increase the demand for emissions units by allowing the Government and/or overseas buyers to purchase them

This may raise the price of carbon, incentivising emissions reductions and removals. But this option includes a lot of uncertainty, and demand from overseas carbon markets is likely to be limited.

Option 3

Restrictions or conditions are placed on removal activities

This means emitters will need to purchase more emissions units from the Government or draw from stockpiled emissions units. This may encourage emitters to reduce their emissions, but it may not encourage new forests to be planted.

Option 4

Emitters will not be able to purchase NZUs from foresters to pay for their greenhouse gas emissions

Emitters would purchase more New Zealand Units (NZUs) from the Government instead. The Government could purchase the removals from forestry to ensure new forests continue to be planted.

As part of the review, the Government will also consider whether the NZ ETS should be changed to:

- improve incentives for native forests
- examine additional types of carbon removals such as from wetlands or direct air carbon capture.

While a higher carbon price leads to faster emissions reductions, it is likely to have a knock-on effect of higher prices for goods and petrol.

The Government recognises the potential impacts of higher carbon prices, particular on lower-income families. Strategies for supporting a fair transition are included in the Government's emissions reduction plan.



Gross emissions reductions – our messages that we think are crucial for a conversation about the role of the NZ ETS in achieving gross emission reductions

Our high-level messages:

- **Substantial reductions in gross emissions are required in the coming decades in order to meet national targets and global temperature goals.**
- **A strong emissions price signal for gross emission reductions is required to help deliver the scale of reductions required.**

Our view of the policy choices available:

- **The ability to influence the gross emissions price signal separately from the forestry incentives is a useful policy outcome from reform of the NZ ETS.**
- **Options 3 and 4 provide the clearest mechanism for achieving specific gross emission reduction pathways.**
- **Detailed decisions, including choices between option 3 and 4 may depend on the scale of forestry differentiation. Not enough information has been provided yet to differentiate between these two options.**

New Zealand has set a national emissions reductions target in line with the Paris-agreement, which is set to be reached by 2030.² The target is to reduce net emissions 50% below gross 2005 levels by 2030 by delivering reductions over the 2021-30 period. This will require significant and immediate efforts as the compliance period has already started. New Zealand has also set targets domestically within the Zero Carbon Act, which call for the delivery of two sets of targets – one for long-lived gases and the other for biogenic methane. While neither of these sets of targets make an explicit call for a specific gross/net emissions balance, CSF would like to see gross emission reductions prioritised under both target frameworks. This is because an approach that is focussed on offsetting gross emissions is an ineffective long-term solution as more and more land is required to maintain this balance.

Of the options provided in the NZ ETS Review, we believe options 1 and 2 do not provide enough clarity, nor strive for enough meaningful change and therefore should not be pursued further by the Ministry. Supporting the entire market by taking units out or changing the Auction Reserve Price (**ARP**) won't establish the prioritisation of gross emission reductions that we believe is warranted.

Options 3 and 4 are substantially clearer in what outcomes they are proposing to achieve and how they could be achieved. While option 4 initially presents as a more detailed approach, and therefore might be expected to produce stronger outcomes, we believe that both option 3 and option 4 have the potential to achieve similar outcomes over the long-term if their implementation settings are chosen correctly. These options should be pursued more thoroughly, with more detailed policy and required regulation to be presented to the public. In the consultation's current form, it is unclear how these options will work when applied to the existing market, and stakeholders should be presented with further detailed analysis of the Ministry's intentions around these options to provide informed submissions.

Relevant NZ ETS Consultation questions: 3.1, 5.1, 5.3, 6.3

² Nationally Determined Contributions ("NDCs") as set out by the Ministry for the Environment. Accessed from: [Nationally Determined Contribution | Ministry for the Environment](#)



Forestry removals – our messages on the role of the NZ ETS in incentivising forestry removals

Our high-level messages:

- **Forestry removals may have different roles in the short-, medium- and long term.**
- **Forestry removals have a broader environmental role to play than just in climate change mitigation; including biodiversity, regional economic and social outcomes and equity.**

Our view of the policy choices available:

- **Emissions pricing has an important role to play for forestry removals, but there is the need for a much broader set of policy levers.**
- **The ability to influence the forestry price signal separately from the gross emissions reductions is a useful policy tool within the NZ ETS.**
- **Options 3 and 4 provide the clearest mechanism for achieving specific outcomes on removals.**

Discussion of NZ ETS Review consultation with respect to forestry removals

The role for forestry removals may be different over the short-, medium-, and long-term. Forestry removals also have a broader environmental and social role to play than just within climate change mitigation. This would include any implications on biodiversity, regional economic outcomes and equity. While emissions pricing does have an effect on the growth of the forestry sector, there is a need for a much broader set of policy levers in order to fully value forestry outcomes and deliver meaningful change.

Forestry is a growth sector, with much of this coming from the conversion of marginal land into “carbon” or production forests. There has been a lack of confidence in the carbon market recently, due to a combination of decisions around NZ ETS settings, the presence of a large volume of stockpiled units, and an uncertainty around the outcomes of the Review consultation. The loss of investor confidence from changes to an environmental incentives market structure has been observed many times globally, notably with respect to renewable energy subsidies in Europe, whereby changes that were implemented retrospectively undermined confidence of participants in those markets.³ Under options 3 and 4, consideration should be given to entities who have made investment decisions based on the previous structure. There is currently a lack of clarity and understanding of how participants and existing holders of NZUs will be treated in light of this review. Because the Ministry’s position on this has remained relatively unclear, there is some discomfort in the market. Increased clarity on the Ministry’s position will have implications for stakeholders.

Options 3 and 4 split the pricing mechanism between removal activities and gross reduction activities. We think this split will provide the clearest mechanism for achieving specific outcomes for both gross reductions as well as forestry removals. We think the ability to treat these prices separately is a useful policy tool within the NZ ETS, as it can increase the cost of gross emissions without automatically attracting further forestry investment. However, additional policies and regulations may still be needed to direct forestry investments, as modelling suggests the volume of forestry NZUs will increase even at relatively low prices. Mechanisms such as the Resource Management Act (**RMA**) reform, the National Policy Statement for Indigenous Biodiversity, log pricing, the cost of land and distance from timber ports can affect the supply of forestry intended for carbon purposes. An outcome that CSF is pursuing

³ Submission to the United Kingdom Parliament in 2015, accessed from: [ICE0075 - Evidence on Investor confidence in the UK energy sector](#)



is the fair treatment of individuals and entities that have invested in forestry assets for removal activities under the current design.

Option to also discuss Permanent Forest Redesign consultation within forestry removals

With respect to the Permanent Forest Redesign Consultation, further clarification from the Government on the definition of a 'transition forest' is required for stakeholders to gain confidence. The science-based evidence behind what qualifies as a transition forest, and how effective forest management can be used in a forest's transition without forest costs increasing significantly should be discussed before committing to a requirement.

We support a redesign of the permanent forest category to reduce the reliance on monocultured exotic species, however more information is required around the credibility of transition forests in a real, matauranga Māori and scientific context.

Relevant NZ ETS Consultation questions: 6.3

Beyond the NZ ETS –levers outside of the NZ ETS to achieve environmental and social outcomes

Our high-level messages:

- **The NZ ETS should be operated as part of a broader policy portfolio and so it doesn't need to be designed to achieve all the outcomes required by itself**
- **Endogenous factors such as the disproportionate impacts on underserved populations and reliance on monocultured exotic species should be considered both inside and outside of the NZ ETS**
- **A broader scope of removal actions holds the potential to incentivise increased removal activities while discouraging land uses that contribute to emissions from such sources.**
- **Given the significant presence of forestry on Māori land, opportunities for positive economic and social outcomes that result in sustainable growth and benefits for Māori should be pursued.**

Our view of the policy choices available:

- **The presence of the additional consultations currently open, such as the biodiversity credits consultation, introduces the possibility of having multiple market mechanisms working in tandem to produce co-benefits.**
- **Prioritise additional removal actions like coastal wetland restoration to maximise carbon sequestration, biodiversity conservation, and resilience to adverse weather. These additional methods should be supported by robust scientific studies evidencing their proposed sequestration capacity to avoid future integrity issues.**

CSF supports the idea of broadening the understanding of value to give weight to endogenous factors, such as the disproportionate impact of changes to the NZ ETS on underserved populations and the reliance on monocultured exotic species. We are also conscious that the primary objective of the NZ ETS is to incentivise emitters to transition to less emissions intensive means of production by increasing the price of abatement and gradually decreasing the volume of abatement units in the market. The primary objective of the NZ ETS is not to deliver on additional outcomes, such as increased biodiversity, or social and community impact. If co-benefits are accounted for within decisions around the NZ ETS, the fungibility of a metric tonne of carbon dioxide or equivalent is called into question.



While these additional factors are important and should be considered, we strongly encourage the Government to consider implementation of complementary market mechanisms to deliver on these outcomes, as opposed to attempting to include them within the design of the NZ ETS. Consultation around the permanent forest redesign⁴ and the potential introduction of a biodiversity credit scheme⁵ are alternative ways to achieve positive environmental and social outcomes beyond climate change mitigation without extending the purpose of the NZ ETS beyond its design.

Option 3 and 4 may allow for external market mechanisms to deliver on these outcomes. Considerations of land use changes, premiums for biodiverse planting and other sequestration activities, such as wetland restoration, could be considered when assessing co-benefits of a project.

CSF supports landowners who have chosen to keep their land planted in indigenous forests and encourages the Ministry to treat these landowners with fairness and recognise the value of their contribution to maintaining biodiversity. CSF also acknowledges the landowners who gain revenue from exotic plantations on otherwise unproductive land. There is a disproportionate effect on Māori, with a high proportion of land restored to Māori ownership through Te Tiriti o Waitangi settlements being situated on marginal land and therefore not being highly productive or profitable before entering into the NZ ETS. While this is a change that will impact not only Māori stakeholders, it is important to acknowledge these factors when considering changes that may affect some landowners more than others.⁶

We acknowledge that there is a far broader scope of carbon removal activities beyond forestry. This holds the potential to incentivise additional removal actions while discouraging land uses that contribute to emissions from such sources. These activities could include coastal wetland restoration or kelp forest regeneration. These actions help to maximise carbon sequestration, promote biodiversity conservation, and build resilience to adverse weather. Recent weather events in Aotearoa highlight the need for resilient ecosystems under good management. Incorporating and broadening the idea of value to include biodiversity and other ecosystem services promotes these activities to be taken up at an investor level and can take the strain off some of our ecosystems. Using tools such as the permanent forest category and a biodiversity credit scheme can help increase consideration of indigenous species as well as alternative projects that extend beyond forestry. Broadening the scope of sequestration activities should also maintain the scientific integrity of any additional sequestration methods. Further policy design by the Ministry should consider the recent changes to the Australian Emissions Reduction Fund, aimed at enhancing the integrity of their sequestration methods to address scientific concerns.

The NZ ETS cannot be expected to deliver on every environmental and social outcome that is desired by the Government. For this reason, while we consider the additional factors discussed above to be highly important, the NZ ETS cannot be relied on as the sole policy lever to achieve multiple environmental and social outcomes. Additional policy and market mechanisms should be implemented to address these elements.

Relevant NZ ETS Consultation questions: 4.4, 7.1, 7.2, 7.4

⁴ [A Redesign of the Permanent Forest Category](#)

⁵ [Exploring a Biodiversity credit system for Aotearoa New Zealand discussion](#)

⁶ [Māori landownership and land management in New Zealand](#)