

19 February 2016

Submission

- to -

NZ ETS Review Consultation  
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## **New Zealand ETS Review Priority Issues**

### **Introduction**

The Wood Processors and Manufacturer's Association of New Zealand welcomes the opportunity to make a submission on the ETS Review 2015/16 and on the priority issues set out in the MfE Discussion Document of 24 November 2015.

The wood processing sector delivers multiple benefits for New Zealand. It is one of the few sectors that align to, simultaneously, the government's economic, social and environmental objectives set out in the Business Growth Agenda.

Expansion of the planted forest resource is very important to wood processing investors. Continued commitment to, and expansion of, domestic processing will be heavily influenced by access to input supply. Achieving economies of scale will help the sector make the necessary long term and large scale investment to grow the share of processing carried out on-shore.

The location of that resource will be important in order that it can deliver on its regional development potential. Targeted afforestation can also deliver additional gains, in particular reducing the cost of achieving government targets for water quality improvement in various catchments. Published and peer-reviewed estimates are already showing that the ecosystems services value of forests amount to billions of dollars to the NZ economy

It is WPMA's view that the overhaul of the ETS must deliver on these important, multiple objectives by supporting one of the few industries (forest and wood products) in NZ operating

at scale and trading globally that is already delivering economic, environmental and social dividends from new, green enterprise and technology. A mere tweaking of rules to assist with NZ's international accounting and carbon trading will continue to mean the scheme falls far short of this. The ETS Review must yield a true market-based mechanism that drives growth of the "real" low carbon economy. It is our view to date that the ETS has not been allowed to operate as a free and open market. This has not only resulted in NZ failing to reduce its emissions profile, created large compliance costs and failed to stimulate the "green" economy.

We believe it important in this consultation to re-emphasize our point made in last year's submission on the INDC. If NZ is to make a real contribution to climate change mitigation then the NZ Government must develop and implement policies that encourage a system-wide approach to managing land use.

Around half of our greenhouse gas emissions are associated with pastoral agriculture and WPMA considers that it is important to send the signal that investors in agriculture will face an orderly and appropriately transitioned price signal. We do not want to see afforestation continue to be undermined by inflated land values created by not including agriculture in the ETS. Farmers also need to be sent a price signal that will stimulate them to hasten adoption low-impact farming methods already becoming a pre-requisite in international food chains supplying discerning consumers.

The proposed continued exemption of the agricultural sector from the NZ ETS is and counterproductive. The result has been to distort land prices and patterns of use. It has resulted in investors seeking to maximise the capital value of land for livestock production for reasons including securing GHG emissions rights, the value of which will increase in response to increasingly stringent international restrictions on emissions. The illogical exclusion of agriculture from the ETS will continue to disincentivise tree planting on farms – the very technology (trees) that is already on hand to enable farmers to become carbon neutral.

## **WPMA, its members and sector value**

WPMA advocates on behalf of a broad membership spanning the whole wood supply chain. WPMA represents one of New Zealand's biggest manufacturing sectors. Our sector epitomises the low carbon/high value manufacturing economy that the nation is striving towards. Our members turn a commodity – logs – into high value, end products marketed in New Zealand and internationally.

WPMA members handle in excess of 85% of the wood processed in New Zealand. We produce pulp, paper, sawn lumber, panels, laminated products and mouldings. Increasingly our members are producing, or have the potential to produce, new construction systems, biochemicals, biofuels, textiles and bio composite material.....protecting the environment and creating jobs simultaneously.

The wood processing and manufacturing sector in New Zealand:

- Delivers \$2 billion GDP.
- Is the 3<sup>rd</sup> biggest export sector at \$2.5 billion per annum.
- Provides 20,500 regional jobs directly and 10,000 indirectly.
- These jobs are concentrated in NZ's poorest regions.

- Is one of these most productive manufacturing sectors showing a 40% rise in output per worker over the last 10 years. This is twice as fast as all manufacturing and 2.5 times as fast as the whole economy.
- Wood processors generate in excess of 70% of their own energy from residues avoiding an estimated \$1.1 billion per year in energy costs which means that this sector uses a higher proportion of renewable energy than any other manufacturing sector.
- Through technology adoption and process optimisation many of our members have been able to voluntarily reduced emissions over the past 25 years on an absolute basis whilst making large productivity gains
- The forests that supply logs to the wood processing and manufacturing sector have been estimated to generate in excess of \$12 billion per year in ecosystem services.

### Specific Submission Points

<i>Question</i>	<i>Response</i>																																													
<p>1. Do you agree with the drivers for the review?</p>	<p>Yes. Whilst the Government may consider the ETS a success in terms of managing its international commitments it has failed at a domestic level to change behaviour to reduce greenhouse gas emissions and to encourage afforestation. In fact as a direct result of the ETS policy we have had net deforestation with conversion mainly to dairy farming, which contributes half of NZ's greenhouse gas emissions. New planting rates are now at record low levels (see graph below). To be in a state of net deforestation places NZ's wood exports at risk in an international trading arena that disfavours products from countries that have shrinking forest resources. It also discourages the scale of investment needed to keep our manufacturing capability at a competitive edge.</p> <div data-bbox="446 1406 1420 1803" data-label="Figure"> <p style="text-align: center;"><b>Figure 1: Estimated Areas of New Planting and Replanting</b></p> <table border="1"> <caption>Estimated data for Figure 1: Estimated Areas of New Planting and Replanting (in hectares)</caption> <thead> <tr> <th>Year</th> <th>New Planting</th> <th>Replanting</th> </tr> </thead> <tbody> <tr><td>1991</td><td>20000</td><td>20000</td></tr> <tr><td>1993</td><td>60000</td><td>25000</td></tr> <tr><td>1994</td><td>95000</td><td>28000</td></tr> <tr><td>1995</td><td>75000</td><td>28000</td></tr> <tr><td>1997</td><td>85000</td><td>28000</td></tr> <tr><td>1999</td><td>40000</td><td>30000</td></tr> <tr><td>2001</td><td>30000</td><td>35000</td></tr> <tr><td>2003</td><td>20000</td><td>38000</td></tr> <tr><td>2005</td><td>10000</td><td>35000</td></tr> <tr><td>2007</td><td>5000</td><td>35000</td></tr> <tr><td>2009</td><td>5000</td><td>30000</td></tr> <tr><td>2011</td><td>10000</td><td>38000</td></tr> <tr><td>2013</td><td>5000</td><td>40000</td></tr> <tr><td>2015</td><td>5000</td><td>42000</td></tr> </tbody> </table> </div>	Year	New Planting	Replanting	1991	20000	20000	1993	60000	25000	1994	95000	28000	1995	75000	28000	1997	85000	28000	1999	40000	30000	2001	30000	35000	2003	20000	38000	2005	10000	35000	2007	5000	35000	2009	5000	30000	2011	10000	38000	2013	5000	40000	2015	5000	42000
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<p>2. What other factors</p>	<p>The ETS Review must deliver on the wider set of objectives set out in the Government's Business Growth Agenda - economic growth, environmental</p>																																													

<p>should the Gov be considering this NZ ETS Review?</p>	<p>protection and social development. The ETS has failed to deliver of wider objectives to date.</p> <p>The Review must also be extended to consider all sectors and all gases if it is to treat all sectors fairly and not continue to rely on substantial subsidies to support sectors (such as agriculture) not included in the review</p> <p>Protecting large emitters from full exposure to the ETS is counterproductive to moving towards the government's ambition for a future low carbon economy producing high value outputs.</p>
<p>3. Should the NZ ETS move to a full surrender obligation for the liquid fossil fuels, industrial processes, stationary energy and waste sectors?</p>	<p>In light of the successful conclusion of the Paris Agreement a move to a full surrender obligation by 2020 is supported but implementation should be subject to ratification of the Paris Agreement.</p>
<p>4. What impact will moving to full surrender obligations have on you or your business?</p>	<p>Moving to full surrender will have immediate and direct impacts in a numbers of areas:</p> <ul style="list-style-type: none"> <li>• Moving to full surrender will significantly increase direct liabilities. For our member companies who are EITE these are, at present, offset to a degree by free allocation but for many others who are not in this category (eg solid wood producers) they will be exposed to a sharp rise in liabilities. It is very important therefore that when free allocation of NZUs comes up for review that a full and complete assessment of <u>all wood processors positions</u> with respect to international competitors is carried out at that time. It will be crucial at this time to bear in mind the effects of renewable energy subsidies and similar support measures our competitors receive, particularly as other countries develop their GHG mitigation policies. WPMA requests that the Government consider the wider wood processing and manufacturing supply chain when reviewing future free allocation. For example, solid wood processors and re-manufacturing businesses do not receive any free allocation and yet they are competing with producers of alternative construction materials (concrete and steel) that currently receive the full 90% allocation level. Compared to this, wood panel producers, also competing with concrete and steel construction products also only receive a smaller 60% allocation. This must be increased.</li> <li>• Indirect costs will probably increase generally in line with the overall NZ wide impact of the surrender change which we would be unable to pass on. One aspect in particular is likely to result in significantly more than normal operating cost increases is in transport.</li> </ul>

	<ul style="list-style-type: none"> <li>• Even though some companies receive an allocation, since the allocation is based on production and not energy usage, the ETS does incentivise them to improve energy efficiency. To date, the ETS has had minimal impact on consideration of long term, large scale energy efficiency projects mainly due to uncertainty with regard to the longer term wider ETS policy settings which results in discounting of the potential impact of the ETS on longer term energy costs/benefits. This also impacts on long term strategic wood processing investment decisions which are an obvious potential contributor to the low emissions economy the ETS is intended to incentivise.</li> </ul> <p>A potential indirect and long term positive impact of a higher carbon price is to bring deforestation to a halt and further to encourage new planting. This would help to ensure long term viability of wood processing in New Zealand through greater confidence in future wood fibre supply and assist in achieving the low carbon economy the ETS is intended to incentivise.</p> <p>The wood processing industry in general and the pulp &amp; paper industry in particular should be considered a low carbon industry so, in theory, if there was a proper global market, a higher carbon price should lead to more investment in this sector.</p> <p>Unfortunately the lack of consistency and transitional settings mean that higher carbon prices in the NZ ETS may give rise to perverse incentives, particularly if increased carbon prices mean some sectors face higher costs while others don't.</p>
<p>5. If full surrender obligations are applied, when should this be implemented?</p>	<p>A phased approach is recommended as it would:</p> <ul style="list-style-type: none"> <li>• Allow for ratification of the Paris Agreement to pass and Rules in the forest accounting area to be clarified before NZ moves to a full surrender obligation.</li> <li>• Allow time for an additional NZU supply mechanism (auctioning) to be established. We consider that the establishment of an auctioning system prior to commencement of full surrender implementation would provide for a smoother price path and hence reduce the risk of price shocks and volatility in carbon prices.</li> <li>• Allow for businesses to incorporate the expected impact in their annually based forward budgeting.</li> </ul> <p>A mid-year change in surrender obligation would create significant additional administrative burden for firms without significant additional GHG-reduction benefit and is therefore not favoured:</p> <ul style="list-style-type: none"> <li>• This was demonstrated in 2010 when for the stationary energy and liquid fossil fuel sectors reporting requirements were doubled with the 1<sup>st</sup> half having a zero surrender obligation and the second half having a 50% surrender obligation.</li> </ul>

	<ul style="list-style-type: none"> <li>Allocation was similarly impacted by half and full year reporting requirements.</li> </ul>
6. If the NZ ETS moves to full surrender obligations, should potential price shocks be managed?	Yes. See comments above
7. If potential price shocks associated with moving to full surrender obligations should be managed, how should this be done?	<p>In a closed domestic market the risk of volatile price movement is high. A combination of actions to manage price shocks and minimise carbon pricing uncertainty over the transition period is recommended.</p> <ul style="list-style-type: none"> <li>The introduction of an auctioning system prior to commencing should phase in.</li> <li>Phase in the full surrender obligation over a 2-3 year period</li> <li>Maintain the fixed price option at \$25.</li> <li>Consider adjusting or removing the fixed price option once auctioning has matured and international linkage has been re- established.</li> </ul>
8. If the \$25 fixed price surrender option value should change, what should it change to and why?	Refer above

Thank you for the opportunity to make a submission on this topic. Please note that the WPMA is part of the Wood Council of New Zealand (Woodco). Woodco has also made a submission which is supported by the WPMA.

Yours sincerely



Dr Jon Tanner  
Chief Executive