

The Treasury

Overseas Investment Act Forestry Review Information Release

June 2022

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Reference: T2021/2357 IM-5-8-4-1

Date: 20 September 2021

To: Associate Minister of Finance (Hon David Parker)

CC: Minister of Finance (Hon Grant Robertson)

Deadline: 22 September 2021
(if any)

Aide Memoire: Ministerial meeting on the role of overseas investment in the forestry sector

Purpose

You are meeting with the Minister of Land Information and the Minister of Forestry on Wednesday 22 September for a whiteboard discussion on the role of overseas investment in the forestry sector. This note provides supporting material, as well as an agency-prepared A3 (see **Annex B**) to support this discussion.

Overview

On 13 September 2021, you met with the Minister of Land Information and the Minister of Forestry to discuss the Overseas Investment Act special forestry test (see T2021/2280 for supporting material provided for that meeting). At that meeting, Ministers expressed interest in having a whiteboard discussion on the role of overseas investment in the forestry sector and sought advice from officials to support this discussion.

Officials from the Treasury, Te Uru Rākau – New Zealand Forestry Service (TUR) / Ministry for Primary Industries, the Ministry for the Environment and the Overseas Investment Office have jointly prepared the attached A to support the discussion. The Treasury has also prepared key messages to support you at the meeting, enclosed as **Annex A**.

Risks with amending overseas investment settings given uncertain role of investment in the forestry sector

[34]

[1]

Next steps

As noted in the A3, Ministers may wish to provide direction to officials on how they would like to see the Forestry Review to proceed within the context of the wider government work programme on forestry.

If Ministers are not satisfied that the Forestry Review will deliver on the outcomes Ministers are seeking for overseas investment in forestry, Ministers may wish to commission advice required from officials, such as on options to:

- progress the Forestry Review as currently scoped and address any of the above issues outside of the Forestry Review
- amend the scope of the Forestry Review to address any of the above issues, where possible, or
- amend the scope of the Forestry Review to undertake more fundamental reform of the Overseas Investment Act forestry settings (though officials note the challenges around this, and that the changes were introduced three years ago).

Current timelines for the Forestry Review

Officials are preparing the discussion document, which Cabinet will consider in November 2021. Officials will then undertake public consultation from December 2021-February 2022. The current Forestry Review timelines would need to be extended to accommodate any scope change to ensure adequate analysis and consultation.

Resourcing implications

Any expansion of the Forestry Review's scope would require a resourcing and reprioritisation discussion with the Minister of Finance.

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Attachments:

- Annex A: Key messages
- Annex B: A3 for Ministerial meeting on the role of overseas investment in the forestry sector (22 Sept 2021)

Annex A: Key messages

Role of the overseas investment screening settings in the forestry sector

- The forestry sector is heavily dependent on access to international capital through inward investment, with up to 70 per cent of forestry plantations being foreign-owned.
- The Overseas Investment Act (OIA) is just one of a range of regulatory instruments impacting forestry settings and influencing outcomes in the forestry sector (and downstream industries).
- Overseas investment in forestry is facilitated through the special forestry test¹, which aims to be more permissive, create more certainty for investors and streamline the processing of applications.

Changing context potentially impacting the nature of overseas investment in forestry

- Since the forestry changes were introduced in 2018, the New Zealand Emissions Trading Scheme (NZ ETS) settings and the rising carbon price are likely to be influencing overseas investment in forestry. These drivers may be more strongly encouraging overseas investment than the original policy intended, or may result in more speculative overseas investment than originally envisaged. Relatedly, rising carbon prices appear to be incentivising greater establishment of permanent exotic carbon forestry.

Overseas investment settings

- Given the changing context, we understand Ministers are interested in exploring existing OIA settings relating to:
 - the **special forestry test** more generally, noting that it was designed to facilitate overseas investment in forestry.
 - **domestic wood processing rights**, with the special forestry test requiring investors to maintain existing log supply arrangements and replant after harvesting.
 - **conversions to new forestry** under the special forestry test is available for both forest acquisitions and conversions to forestry. Most land transacted under the SFT is for existing forestry (79%) rather than conversions (21%).
- Permanent forestry investments cannot use the streamlined pathway and are subject to the most stringent overseas investment screening – the full benefits test.
- The role of forestry standing consents, a form of pre-approval, in facilitating overseas investment was also raised at the 13 September meeting. Ministers make decisions on applications for standing consents, including the scope of standing consent conditions (e.g. permitted number of transactions or total area of land).

¹ The 'special test relating to forestry activities', known as the 'special forestry test'.

Other options

- Given the check-list nature of the special forestry test, there is no opportunity to meaningfully address these issues through operational change or operational guidance.
- [36]

Reputational risks and potential impact on bilateral relationships

- One of the drivers of the introduction of the streamlined test three years ago was a *quid pro quo* with the forestry investment industry for bringing forestry rights into the screening regime.
- [1]

- Changes to the screening rules could impact New Zealand's attractiveness for foreign direct investment more generally.

Overview			
<ul style="list-style-type: none"> The Associate Minister of Finance, Minister for Land Information and Minister of Forestry are meeting to discuss the role of overseas investment in the forestry sector. Officials from the Treasury, Te Uru Rākau – New Zealand Forestry Service / MPI, the Ministry for the Environment and the Overseas Investment Office (OIO) have jointly prepared this A3 to support the discussion. 			
Current state / problem definition	Opportunities through Forestry Review	Other opportunities, key trade-offs and considerations within overseas investment regime	Current Government work programmes across forestry sector
Overseas ownership of forestry			
<p>The forestry sector is heavily dependent on access to international capital through inward investment, with up to 70 per cent of forestry plantations being foreign-owned.</p> <p>Overseas investment in forestry is facilitated through the special forestry test (SFT), which aims to be more permissive, create more certainty for investors and streamline the processing of applications.</p>	<p>There is no scope to meaningfully address this issue through the current Forestry Review, as the stated intention is to test the operation and effectiveness of the 2018 changes, rather than reconsider the original policy intent.</p>	<p>Moderate scope to address issue through the OIA, but would entail significant risks (and require legislative change)</p> <p>Opportunity</p> <p>The OIA, either as an outcome of an amended Forestry Review or separately, could be adjusted to remove the SFT, with forestry investments instead subject to the most stringent overseas investment screening – the full benefits test. The SFT could also be amended to change some of the check-list requirements, though there are clear limits to how far any amendments could go without become a qualitative assessment more akin to the benefits test. [1]</p> <p>Key trade-offs</p> <p>The ownership patterns and investment challenges of the forestry sector that motivated the introduction of the SFT are still here. Given the forestry sector's heavy reliance of international capital through inward investment, removing the SFT may have a significant impact on the forestry sector and related industries (including the domestic wood processing industry and future bio-economy related opportunities) and may impact New Zealand meeting its emissions budgets and emissions reduction targets.</p> <p>Considerations</p> <p>Changes to the screening rules may impact many of the Government's priority areas, including enhancing regional development and employment, and mitigating climate change.</p> <p>One of the drivers of the introduction of the streamlined test three years ago was a <i>quid pro quo</i> with the forestry investment industry for bringing forestry rights into the screening regime. [1]</p>	<p>The Forestry and Wood Processing Industry Transformation plan is investigating issues relating to:</p> <ul style="list-style-type: none"> [33]
Conversion to new forestry			
<p>Most land transacted under the SFT is for existing forestry (79%) rather than conversions (21%).¹ Overseas investment transactions are likely a relatively small proportion of the overall land converted into forestry (production and permanent) in the last three years – around 22%.²</p> <p>There is a range of factors, including ETS reforms, higher carbon prices, government afforestation schemes, and high log prices, that are driving a recent increase in forestry conversions.</p>	<p>Under the current ToR, the Forestry Review will not consider the appropriateness of applications to convert farmland to forestry using the SFT. This is because the Review is not considering changes to the overall forestry settings and because conversions of farmland to forestry are better considered as part of the broader work on addressing afforestation concerns.</p>	<p>Relatively straightforward to make a significant impact on settings, but would require legislative change, and would likely not be effective at addressing holistic land use change concerns in New Zealand</p> <p>Opportunity</p> <p>[1] This would be a relatively straightforward amendment to the Act and bring it back in line with the drafting that was initially introduced to Parliament.</p> <p>Key trade-offs</p> <p>[1] A relatively small proportion of total land conversions are transacted through the SFT (over the past three years, there have been consents for 23,402 ha of new planting through the STF relative to an estimate of 105,200 ha of exotic afforestation in New Zealand since the beginning of 2019).</p> <p>In addition, forestry is likely to play an important role in meeting the country's emissions budgets and targets and this move could be seen as a signal to the sector on the role of afforestation in meeting emissions budgets.</p> <p>Considerations</p> <p>[1]</p>	<p>The role of forestry in our climate change targets (including NZ ETS settings and the impact of the carbon price) are being considered through the Forestry, Climate Change and Land Use work programme as part of the ERP.</p> <p>[33]</p>

¹ Land purchased for conversion can also be subdivided and sold under the test (e.g. rather than using some farmland for forestry).

² Note that the available data are not directly comparable in that there is a lag between OIO approval, purchasing of land and eventual planting.

³ Land use capability

Current state / problem definition	Opportunities through Forestry Review	Other opportunities, key trade-offs and considerations within overseas investment regime	Current Government work programmes across forestry sector
Domestic wood processing			
<p>The SFT requires investors to maintain existing log supply arrangements and replant after harvesting. During the Forestry Review, some stakeholders questioned the practical effect of the log supply requirement given, for example, that very few contracts are for long-term supply.</p> <hr/> <p>Ministers may have concerns that making it easier for overseas investors to purchase forestry land and forestry rights may lead to more logs being sent offshore for processing, with negative impacts on local log supply for domestic processing and employment.</p>	<p>Under the Terms of Reference (ToR), the Forestry Review will only consider the extent to which the changes are aligned with the Government's objectives for domestic wood processing.</p>	<p>Very limited scope [1]</p> <p>Opportunity A new benefit factor (e.g. 'offering wood to domestic processors') could be introduced to the benefits test. However, applicants are unlikely to use the benefits test as long as the SFT is available, so this option is unlikely to be effective unless the SFT were removed.</p> <p>Key trade-offs Using the OIA to increase domestic wood processing is complex, [1] Introducing a requirement for overseas investors to increase domestic wood processing in order to access the SFT may undermine the advantages of the 'checklist' nature of the SFT. [1]</p> <p>Considerations Many of the challenges that domestic wood processors are facing in accessing a secure supply of logs cannot be resolved through the screening process contained in the OIA (e.g. high export log prices, subsidies in overseas wood processing sectors, lack of suitable logs and lack of scale may be contributing factors) as iterated by the Forestry Ministerial Advisory Group. Any proposal to address this issue through the OIA will require careful consideration, [1] Using the OIA to increase domestic wood processing may also introduce efficiency costs, which tend to flow through to higher structural costs for the sector as a whole [1]</p>	<p>The Forestry and Wood Processing Industry Transformation plan is leading policy development to address:</p> <ul style="list-style-type: none"> • [1] • •
Permanent forestry ('carbon farming')			
<p>Permanent forestry investments cannot use the streamlined pathway and are subject to the most stringent overseas investment screening – the full benefits test.</p> <hr/> <p>Ministers may be concerned that increasing carbon prices is incentivising greater establishment of permanent exotic carbon forestry, particularly of productive arable land.</p>	<p>Under the current ToR, the Forestry Review will not consider whether carbon farming (permanent forestry) should be able to begin to use the SFT.</p>	<p>Very limited scope to address Ministerial objectives within the Overseas Investment Act</p> <p>Considerations There are limited options under the OIA to address this issue given that permanent forestry investments cannot use the SFT and are subject to the most stringent overseas investment screening. This issue is being progressed through the Forestry, Climate Change and Land Use work programme, as part of the ERP. It will consider NZ ETS and Resource Management options for the management of permanent forestry.</p>	<p>The role of forestry in our climate change targets (including NZ ETS settings and the impact of the carbon price) are being considered through the Forestry, Climate Change and Land Use work programme as part of the ERP.</p>

Next steps
<ul style="list-style-type: none"> • Provide direction to officials on the direction of the Forestry Review within the context of the wider government work programme on forestry • If Ministers are concerned that the current work programme will not deliver on the outcomes Ministers are seeking for overseas investment in forestry, commission advice from officials to consider detailed options including: <ul style="list-style-type: none"> ○ progressing the Forestry Review as currently scoped but addressing any of the above issues through amendments to processes outside of the Overseas Investment Act ○ amending the scope of the Forestry Review to address any of the above issues, where possible, or ○ amending the scope of the Forestry Review to undertake more fundamental reform of the Overseas Investment Act forestry settings (though officials note the challenges around this, including limited scope for significant revision and the length of time since last reform). • Note substantial resource and prioritisation pressures within the Treasury – currently resourced to deliver a narrow operational review of the Forestry provisions. Any expansion of the Forestry Review's scope would require a resourcing and reprioritisation discussion with the Minister of Finance. <p><i>Current timelines for the Forestry Review</i></p> <ul style="list-style-type: none"> • Officials are preparing the discussion document, which Cabinet will consider in November 2021. Officials will then undertake public consultation from December 2021-February 2022.