



Ministry for the
Environment
Manatū Mō Te Taiao

Ministry for Primary Industries
Manatū Ahu Matua



To: Hon Todd McClay, Minister of Agriculture

Hon Simon Watts, Minister of Climate Change

From: Julie Collins, Deputy Director-General, Policy & Trade

Sam Buckle, Deputy Secretary, Climate Change Mitigation and Resource Efficiency

Climate Change Response Act 2002 Amendments: New Zealand Emissions Trading Scheme obligations for agriculture

| | | | |
|-------------|------------------|------------------------|----------|
| Date | 19 February 2024 | Reference (MPI) | B24-0127 |
| | | Reference (MfE) | BRF-4249 |

| Decision required | Date decision required by |
|-----------------------------------------------------------------------|---------------------------|
| YES <input checked="" type="checkbox"/> / NO <input type="checkbox"/> | 23 February 2024 |

| Other agencies/industries consulted on during the production of this briefing |
|-------------------------------------------------------------------------------|
| Environmental Protection Authority <input checked="" type="checkbox"/> |
| The Treasury <input checked="" type="checkbox"/> |

Purpose

This briefing seeks your direction on amendments to the Climate Change Response Act 2002 (CCRA), which are required by December 2024 to 'Keep agriculture out of the Emissions Trading Scheme'.

Key messages:

1. We seek your direction on amending the CCRA by December 2024, to support the National Party's Election Manifesto commitment to "Keep agriculture out of the Emissions Trading Scheme and implement a fair and sustainable pricing system for on-farm agricultural emissions by 2030 at the latest".
2. Making this amendment will present an opportunity for you to highlight your plans for reducing agricultural emissions, including milestones and high-level timeframes. This will help to set strategic direction for the sector and provide certainty, as well as mitigate stakeholder concerns about amending the backstop.

3. An amendment is required as the CCRA requires agricultural processors to pay for their emissions from 1 January 2025 via the New Zealand Emissions Trading Scheme (NZ ETS), and for farmers to report their emissions from 1 January 2026, and pay for them from January 2027.
4. Amendments to the CCRA are needed by December 2024 to stop these requirements. You have choices on how to amend the CCRA which will have implications on meeting manifesto commitments, signals sent to the sector, passing legislation this year, and progress towards reducing agricultural emissions.
5. To amend the CCRA by December 2024, the Bill needs to be prioritised, with introduction in May and with First Reading in June 2024. We recommend, following your direction, that you lodge a Cabinet paper by 21 March for consideration by the Economic Policy Committee on week of 25 March and Cabinet by 2 April 2024, with the intention that a Bill is introduced to the House as soon as possible thereafter.

Context

6. The National Party's Election Manifesto commits to "Keep agriculture out of the Emissions Trading Scheme and implement a fair and sustainable pricing system for on-farm agricultural emissions by 2030 at the latest".
7. In your bilateral meeting on 31 January, which was focussed on reducing agricultural emissions, you agreed to:
 - a) direct the Ministry for the Environment (MfE) and the Ministry for Primary Industries (MPI) officials to work jointly on the CCRA backstop amendments and provide advice on options for amending the backstop;
 - b) 9(2)(f)(iv)
 - c) publicly signal the high-level milestones and timeframes to deliver the reducing agricultural emission plan (the plan) before the CCRA backstop amendments are introduced. The intention of this is to place CCRA amendment decisions within the context of wider strategy for agricultural emissions, and decisions related to agriculture and climate change; and
 - d) use the final agriculture chapter in the upcoming emissions reduction plan (ERP 2) to outline further detail on this high-level plan.
8. The NZ ETS backstop was put in place in 2020 to support progress towards developing an alternative pricing system for agricultural emissions by 2025. It also sends a signal to incentivise actions to reduce agricultural emissions to support New Zealand's emissions reduction goals.
9. Currently, the NZ ETS backstops requires:
 - a) animal and fertiliser processors to pay for their emissions (via surrendering units in the NZ ETS) from 1 January 2025. Agricultural processors have been monitoring and reporting their emissions since 2011; and

- b) farmers to monitor and report their emissions in the NZ ETS from 1 January 2026 and pay for these emissions from 1 January 2027¹.

Analysis and advice

- 10. There are a range of options available to keep agriculture out of the NZ ETS. To inform analysis of the available options there are various criteria you could consider²:
 - a) deliverable by December 2024 – ability of amendment to be delivered (through departmental, Cabinet, and parliamentary processes) by December 2024 to avoid processor level pricing by 1 January 2025;
 - b) manifesto and coalition agreements – amendments are consistent with the positions set out in manifesto or coalition documents;
 - c) signals future intentions – provides a signal that supports reducing emissions as well as to the path Government policy is expected to follow; and
 - d) emissions reduction – whether the amendment supports progress towards our international and domestic climate change targets and obligations.
- 11. The weighting you give these considerations will determine your preferred option.

There are different options for keeping agriculture out of the NZ ETS:

Option One: Full repeal and complete removal of NZ ETS obligations

- 12. This would completely remove agricultural activities from the NZ ETS³. As such, fertiliser and animal processors and animal-farmers will have no reporting or surrender obligations in the NZ ETS, for their associated methane and nitrous oxide emissions. Their carbon dioxide emissions, for example from on-farm transport, would still be priced in the NZ ETS.

Option Two: Minimal amendments to remove farm level reporting and surrender obligations and processor level surrender from the NZ ETS

- 13. This option ‘deactivates’ the NZ ETS agricultural provisions not already in effect (so agricultural processors would not be required to pay for their emissions from 1 January 2025, and farmers would not be required to report from 2026 and pay for their emissions from 2027).⁴ These provisions would remain in the CCRA, and the Minister would be able to ‘reactivate’ them in the future via Order in Council. This would mean that, in the future, the Minister could decide to introduce NZ ETS surrender obligations for agricultural processors and/or farm level reporting and surrender obligations.
- 14. Under this option, agricultural processors who are currently reporting their emissions would continue to do so.

¹ Definition of animals–farmer activity The Climate Change Response Act 2002 defines animals–farmer activity as: farming, raising, growing, or keeping ruminant animals, pigs, horses, or poultry for: a) reward; or b) the purpose of trade in those animals, animal material or animal products taken or derived from those animals.

² A broader range of criteria will be used in the Regulatory Impact Analysis for the CCRA Amendment.

³ By repealing part 5 of Schedule 3 of the CCRA and associated sector-specific provisions.

⁴ These are primarily located in sections 2A(5C) and (5D), and 219 of the CCRA.

15. Note that we anticipate that all NZ ETS agricultural provisions would be repealed through the legislation implementing the Government's new agricultural pricing system.

Option Three: Minimal amendments to retain a processor-level pricing backstop.

16. This option would amend the CCRA to delay processor-level surrender obligations. This will support action towards pricing by 2030 by keeping the lever of processor-level pricing, while allowing time to develop an alternative pricing system that keeps agriculture out of the NZ ETS.
17. This option would also amend the CCRA by removing all farm level reporting and surrender obligations.
18. In addition, as with Option Two we anticipate that all remaining NZ ETS agricultural provisions would be repealed through the legislation implementing the Government's new agricultural pricing.

Options considered but discarded.

19. Officials also gave consideration as to whether the CCRA amendment required to manage backstop obligations could be used as a vehicle to progress alternative legislatively backed action to support the reduction of agricultural emissions. One example of such an option would be to support the uptake of mitigations or implement an interim levy-based system of some kind.
20. However, Officials have determined that these options are not feasible within the required timeframes. Rather, consideration of such options will be included in scope of the advice being prepared on options to support the uptake of mitigations.

Analysis of options

21. Without an alternative mechanism in place, Options One to Three carry the risk to our domestic and international emissions target achievement. These risks can be mitigated by the Government setting out a clear alternative agricultural emissions plan by the time of the CCRA amendments are being progressed.
22. Previous modelling (see **Appendix One**) shows the impact of a processor levy on emissions reductions and the agricultural sector. The results showed substantial emissions reduction (16 percent). This emissions reduction is driven by land use change from the dairy, sheep, and beef sectors towards cropping and forestry production, and has results in decreases in milk and meat production. Contrary to recent work by processors to implement Scope three emissions reduction targets, the modelling processors were assumed to not be able to drive mitigation uptake on farm.
23. Removing the processor level surrender obligations would negatively impact progress towards emissions reduction targets if no other action were taken in its place.

24. Option One removes all NZ ETS agricultural obligations in the CCRA, supporting the Government's intention to keep agriculture out of the NZ ETS and send a clear signal to the sector of the Government's intentions. This option also removes the pricing signal from the NZ ETS completely which may disincentivise the agriculture sector to make changes to reduce agricultural emissions if they think that pricing is completely off the table.
25. Option Two deactivates the farm level reporting and surrender obligations and processor level surrender obligations. This keeps these obligations from starting, allowing time for the development of an alternative pricing system. However, if sufficient progress is not made, the Minister maintains the ability to reactivate them (or completely remove them later) via Order in Council, thereby mitigating some of the risks and negative signals that completely removing the backstop may send.
26. Option Three leaves in place the processor level surrender obligations but postpones the implementation date. This gives powers for Cabinet to impose surrender obligations on processors in the future should an alternative scheme not be agreed to and/or implemented in time. This option maintains the positive signal for pricing and mitigates some of the risk to New Zealand's domestic and international reputation. However, this option could be perceived to be inconsistent with the Government's intention to keep agriculture outside the NZ ETS.

Risks


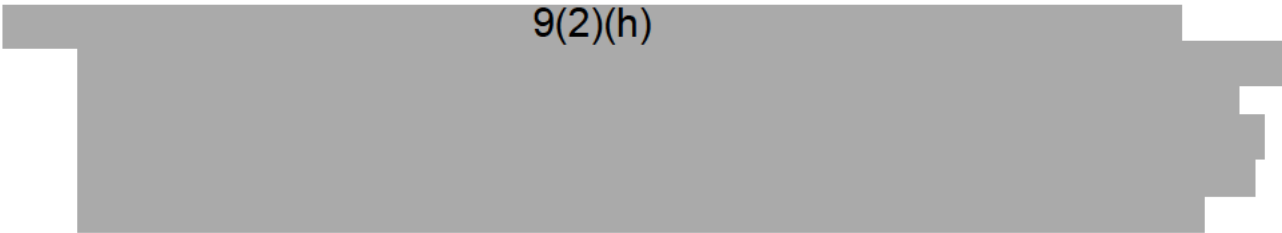
27. The risks that accompany the proposed CCRA amendment are outlined below.

Timeframe risks

28. Timeframes are challenging for passing legislation this year. The challenges include time for policy development, drafting the bill with Parliamentary Counsel Office (this has been reduced from 44 days to 25 days), and reduced time for Ministerial consultation. One of the significant challenges is that the mid-recess means Cabinet Legislation Committee decisions need to be made in May to enable first reading in June and a four month select committee process.
29. If there are delays, there are potential options for further truncating process, for example going straight to Cabinet and bypassing Cabinet Committee, however this will save minimal time. If there are any delays preparing the Bill, the Government may need to consider truncating the Parliamentary process to meet the 31 December 2024 deadline. That process would likely require time-unlimited debateable motions such as considering the Bill under urgency or shortening the Select Committee to less than four months.

9(2)(h)

9(2)(h)



Consultation and stakeholder risks

33. Officials have not specifically consulted on amending the CCRA to 'keep agriculture out of the Emissions Trading Scheme'. The CCRA Amendment Bill will go through the Select Committee process where it will have public consultation and scrutiny from Parliament.
34. Last year, the Government consulted on deferring NZ ETS reporting obligations for animal farmers in August 2023. Public consultation on whether to defer NZ ETS obligations for animal farmers and progress the Order in Council ran from 18 August to 6 September with 1,225 submissions received. Through this consultation, most sector submitters continued to support an agricultural emissions pricing system outside of the NZ ETS as they considered it would provide greater opportunities to develop a more effective solution.
35. Māori submitters considered that there would be increased administrative costs as a result of animal farmers' obligations under the NZ ETS. The majority of submissions received who opposed the deferral expressed frustration over the delays to pricing agricultural emissions and raised concerns that any delay would have a detrimental effect on the path towards mitigating agricultural emissions.

Next steps

36. Officials request feedback on your preferred option by Thursday 23 February 2024.
37. Following your agreement on the preferred option, Officials will jointly provide a Cabinet paper seeking final decisions on amending the CCRA to repeal NZ ETS agricultural obligations to the Economic Policy Committee. A Regulatory Impact Statement will also be drafted by officials.
38. Officials will soon provide you with advice on the high-level timeframe to deliver reducing agricultural emission actions, which can be publicly signalled prior to the agricultural backstop repeal bill being introduced. Decisions made on that briefing will further inform the drafting of the Cabinet paper - and the public communication of the agreed approach will help to provide certainty, and signal intent, to the sector.

Proposed timelines and process for progressing decisions to Cabinet

39. To obtain Cabinet's agreement on the draft Cabinet paper and legislation by the end of the year, we recommend working to the timeframes set out in the table below.

| Action | 2024 |
|-------------------------------------------------------------|----------------------------|
| Feedback provided on preferred option | By 23 February |
| Cabinet paper is reviewed, finalised, and sent to Ministers | 8 March |
| Ministerial consultation | 11 March to 19 March |
| Lodge papers | 21 March |
| Economic Policy Committee (ECO) | Week of 25 March |
| Cabinet approval | 2 April |
| Bill drafting and LEG Committee | May |
| Introduction of the Bill | May |
| First Reading | June |
| Select Committee (Four months) | July to the end of October |
| Second and Third reading and Committee of the Whole | November |
| Royal Assent | December |

Recommendations

40. It is recommended that you:

- a) **Note** that a Bill needs to be passed this year to 'Keep agriculture out of the New Zealand Emissions Trading Scheme', ideally with introduction in May and with First Reading in June 2024.

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- b) **Agree** to indicate your preferred option to amend the CCRA to 'keep agriculture out of the ETS':

Option One: Full repeal and complete removal of NZ ETS obligations;

YES / NO

Option Two: Minimal amendments to 'disable' new reporting and pricing obligations in the NZ ETS; and

YES / NO

Option Three: Minimal amendments to retain a processor-level backstop.

YES / NO

- c) **Note** following your direction, Officials will draft a Cabinet paper that needs to be lodged by 21 March 2024 to be considered by the Economic Policy Committee on the week of 25 March 2024 and Cabinet on 2 April 2024.

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Julie Collins
Deputy Director-General
Policy & Trade

Hon Todd McClay
Minister of Agriculture

/ / 2024



Sam Buckle
Deputy Secretary
Change Mitigation and Resource Efficiency

Hon Simon Watts
Minister of Climate Change

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Appendix One: Impact of processor level pricing in the NZ ETS

The results in the table below show the estimated economic impact, and projected emissions reductions, of processor level pricing for the 2030 base year. The New Zealand Emissions Trading Scheme price is assumed to be \$110 per tonne CO₂^e in 2030 and 90 percent free allocation is applied. The modelling was done by Manaaki Whenua Landcare Research.

| Outcomes | Impact of Processor level pricing in NZ ETS |
|---------------------------------------|---------------------------------------------|
| All gases | –16 percent |
| Methane | –17 percent |
| Nitrous oxide | –13 percent |
| Commodity production | |
| Milk solids (t) | –8 percent |
| Lamb (t) | –19 percent |
| Beef (t) | –51 percent |
| Net revenue | |
| Dairy | –10 percent |
| Sheep & beef | –32 percent |
| Total agriculture and forestry sector | –6 percent |
| Land–use change | |
| Dairy | –4 percent |
| Sheep & beef | –16 percent |
| Indigenous forest / scrub | 14 percent |
| Arable | 7.8 percent |