



Next steps on agricultural emissions pricing

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	Action sought:	Response by:
Hon James SHAW, Minister of Climate Change Hon Damien O'CONNOR, Minister of Agriculture	Provide feedback to officials	27 April

Actions for Ministers' Office Staff	Return the signed report to MfE and MPI.
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Key contacts – Ministry for the Environment

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Director	David Mead (Acting)	022 023 4190	

Key contacts – Ministry for Primary Industries

Position	Name	Cell phone	1st contact
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Responsible manager	Fleur Francois – Climate Change On-Farm Mitigation and Inventory	9(2)(a)	
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Next steps on agricultural emissions pricing

Key Messages

1. Last week, Ministers met to discuss how to progress the pricing of agricultural emissions. Given the challenges of implementing a pricing system by 1 January 2025, Ministers requested advice on some of the system's components that could be progressed in the short term.
2. If decisions are not made and legislation not passed before 2025 on an alternative system for agricultural emissions, agricultural emissions will enter the New Zealand Emissions Trading Scheme (NZ ETS) in 2025, in some form.
3. Officials propose to provide advice within the next month on the components you requested. Advice will cover key choices Ministers need to make to progress the policy package through to Cabinet, including on:
 - Farm-level reporting - decisions include timeframes for implementation, objectives of reporting system, the scope and level of mandate.
 - NZ ETS obligations for animals-farmer activities outlined in the Climate Change Response Act 2002 (CCRA) - decisions include whether to defer both reporting and surrender obligations for animals-farmers, by how long to defer and timeframes for this work programme.
 - Sequestration innovation pathway and including additional categories in the NZ ETS - decisions include the scope of the legislative process and level of scientific analysis required.
 - Pricing fertiliser emissions at a processor level – a primary decision is needed with detailed analysis on pricing processors within the NZ ETS or through a levy, and subsequent decisions on levels of free allocation, setting of levy prices, and preferred timeframes.
4. Ministers' decisions on these areas are necessary to finalise a proposed pathway for Cabinet, legislation and implementation. There are several trade-offs that will need to be made on timeframes, and the scope of work that can be delivered.

Recommendations

We recommend that you:

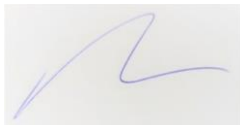
- a. **Agree** officials will provide you with further advice on:
 - i. proceeding with mandatory farm-level emissions measurement and reporting;
 - ii. options for deferring obligations for animals-farmer activities in the NZ ETS;
 - iii. recognising all scientifically valid sequestration in the NZ ETS, and the creation of a sequestration innovation pathway to support this, where this is practicable; and
 - iv. options for pricing synthetic nitrogen fertiliser at the processor-level.

Yes/No
- b. **Note** following direction from you on these key issues, officials will provide detailed work programmes including legislative and implementation timeframes.

Yes/No
- c. **Agree** to meet with officials to discuss Ministers' feedback.

Yes/No

Signature



David Mead
Acting Director, Markets Development
Ministry for the Environment

Hon James SHAW
Minister of Climate Change
/ /2023

9(2)(a)



Charlotte Denny
Director, Natural Resources Policy
Ministry for Primary Industries

Hon Damien O'CONNOR
Minister of Agriculture
/ /2023

Purpose

5. The purpose of this briefing is:
 - To clarify and confirm officials' understanding of Ministers' direction to progress agricultural emissions pricing following the meeting between Ministers on 13 April; and
 - To set out proposed next steps and timeframes.

Context

6. Ministers met with the Prime Minister on 13 April to discuss how to progress agricultural emissions pricing. In this meeting Ministers:
 - i. remained committed to pricing agriculture emissions in the long-term
 - ii. recognised the significant challenge in implementing a farm level pricing system by 1 Jan 2025 (DEV-23-SUB-0052; MPI AM23-0158; MfE BRF-3043 refers)
 - iii. signalled a desire to sequence the implementation of farm-level pricing into more deliverable components.
7. Ministers also requested advice on:
 - i. proceeding with mandatory farm-level emissions measurement and reporting
 - ii. deferring farm-level reporting obligations for animals-farmer activities in the NZ ETS
 - iii. a desire to recognise all scientifically valid sequestration in the NZ ETS, and the creation of a pathway to do so, where this is practicable
 - iv. options for pricing synthetic nitrogen fertiliser at the processor level.
8. This briefing sets out the key considerations and choices across these four areas and outlines our planned approach to provide further advice to support Ministers to make decisions.
9. The design of some aspects of the immediate next steps (e.g., farm-level reporting, synthetic nitrogen fertiliser pricing) may differ depending on the chosen long-term system for pricing agriculture emissions.
10. Sequencing the system will require prioritisation of some aspects of farm level pricing, in advance of the whole system being implemented.
11. The default option is that agricultural emissions will enter the NZ ETS in some form in 2025. Amendments to primary legislation prior to 2025 are needed regardless of which option Ministers choose.

Interim Mandatory Farm-level emissions reporting

12. Ministers requested advice on setting up mandatory farm level emissions measurement and reporting ahead of farm level pricing. Adopting a phased approach will result in less agricultural emissions reductions over the short-term.
13. Ministers discussed the necessary components of this reporting system as being:
 - **Emissions methodology and standards:** Amendments will be required to the CCRA to introduce non-NZ ETS¹ mandatory reporting requirements for farm level emissions. Legislation will set out the reporting requirements, methodologies, and other components needed to support farm level reporting (e.g., emissions factors).
 - **Centralised registry and database:** A centralised government-led registry and database to register participants and capture emissions reporting data. This could align with emissions reporting for other sectors.
 - **User and system interface:** The platform(s) that farmers can utilise to enter data into. There are opportunities to link this system through to platforms provided by non-government organisations. Previous advice to the Minister of Climate Change (MfE BRF-2770 and MfE BRF 2863) advised that if there is a legislated requirement for farmers to report emissions, then a freely accessible platform should also be provided by government.
14. There are several interconnected choices that Ministers will need to make regarding implementation of farm-level reporting.

Timeframes and objectives for delivery of farm-level reporting

15. An important consideration regarding the delivery of a measurement and reporting system is when Ministers want to have the system in place, and also when they consider that the full emissions pricing system should begin.
16. Any mandated legislated farm level emissions reporting system will need to follow a similar process as the emissions pricing pathway previously advised on (DEV-23-SUB-0052 /MPI AM23-0158 / MFE BRF-3043). This is due to the legislative and system build requirements.
17. Leveraging off existing policy decisions on emissions pricing in the s215 report would expedite this process. If Ministers seek to re-visit any of this, it will affect implementation timelines.
18. We will also require guidance on when and how the emissions reporting should transition to farm level pricing.

¹ Noting that the CCRA currently has provisions for NZ ETS related farm level reporting for animals from 1 January 2024.

19. Ministers' decisions on the objectives for an emissions and levy reporting and accounting system and how this compares to the current pricing system design will influence timeframes for implementation.

Scope of reporting, and level of mandating

20. Related to timeframes and objectives of the reporting system, Ministers will need to decide on the scope of reporting (e.g., inclusion of mitigations and sequestration) and the extent to which this is mandated.
21. To make reporting mandatory, legislation will be required to define:
 - the participants that need to report their emissions, and the scope of emissions to be reported;
 - establish a power to set regulations to define emissions reporting methods and standards; and
 - set any penalties for any failure to report.

Current CCRA NZ ETS reporting requirements

22. The CCRA currently sets out that reporting obligations for animals-farmer activities under the NZ ETS will begin on 1 January 2024 and surrender obligations will begin for both fertiliser and animals-farmer activities on the 1 January 2025. The CCRA provides for the ability to defer this animals-farmer reporting requirement through an Order in Council to a future date.
23. This requirement needs to be deferred to a later date until a more substantive repeal of the legislation can be done alongside the introduction of new reporting and/or pricing requirements.
24. Note there are also surrender obligations for animals-farmers and fertiliser-processors to begin in 2025. These were intended to be repealed under amendments to primary legislation when the new pricing system was introduced.
25. The fertiliser-processor surrender obligations cannot be deferred by an Order in Council as they are already reporting (this will need to be primary legislation change when a plan for when these emissions will be priced is determined. However, the animals-farmer 2025 surrender obligations could be deferred alongside the animals-farmer reporting requirements as these requirements have not yet commenced, in which case animals-processor surrender obligations will apply from 2025.
26. A decision by the Minister of Climate Change is required on initiating the process for deferral. Currently, the Environmental Protection Authority (EPA) has no ability to efficiently receive these emissions reports, nor are farmers likely to be aware of or prepared to comply with the reporting requirement.

27. As no previous consultations have covered the proposal to defer, consultation is required before an OIC can be made. The consultation would be on the decision to defer, and when to defer it to (*legally privileged*).
28. In making the decision to defer, the Minister of Climate Change must have regard to matters set out in section 2B(5) of the CCRA.
29. Ministers requested advice on the process for the Order in Council deferral, including timing of consultation.
30. This consultation may be an opportunity for the Government to set out its plans for farm-level measurement and reporting (as set out above). We will consider the linkages here in our subsequent advice.
31. We will provide further advice to the Minister of Climate Change to make a decision on next steps for deferral of NZ ETS obligations for animals-farmer activities by the end of this month.

Innovation pathway and recognition of additional categories in the NZ ETS

32. We understand Ministers are interested in recognising additional removals activities within our climate policy framework, including how to design an 'innovation pathway'. The innovation pathway aims to encourage additional private sector research investment into carbon sequestration data, to allow new categories to enter the NZ ETS.
33. The innovation pathway covers a broader range of sequestration and removals and is not focused solely on categories of on-farm sequestration. The upcoming Carbon Removals Strategy Cabinet paper is an opportunity to secure Cabinet's agreement to the innovation pathway's design and next steps.
34. For the innovation pathway, more work is required to scope the legislative mechanisms to enable new forms of removals to be recognised and the process to establish the required level of scientific analysis. Some of this may be identified as part of current work, including:
 - *Expanding the Nationally Determined Contribution (NDC) category* is a critical enabler that should be complete before new categories are added to the NZ ETS. MfE and MPI have been preparing advice on expanding the NDC categories and this will be provided to Ministers later this month.
 - *Adding new categories in the NZ ETS* - There is significant work required to identify legislative changes and operational processes.
 - *Max Carbon research and policy programme* is already looking at better measuring carbon storage in forests, quantifying the impacts of active management on additional carbon storage, and remote sensing and measurement.

35. This innovation pathway approach would fast track Government's previous promise to recognise sequestration within the NZ ETS in the long term. However, during consultation last year, submitters did not support the NZ ETS as the long-term system for rewarding on-farm sequestration because it was seen as too complicated with high compliance costs, especially for small areas of vegetation.
36. This approach is not consistent with previous public commitments, including the Prime Minister's announcement at 2022 Fieldays, to work on a sequestration strategy with the He Waka Eke Noa Partnership.

Pricing synthetic nitrogen fertiliser at the manufacturer and importer level

37. Ministers requested advice on options for pricing synthetic nitrogen fertiliser at the manufacturer and importer level.² Ministers have several key policy decisions to make on how exactly to price the emissions associated with the application of synthetic nitrogen fertiliser. Officials will provide further advice on the following matters, including potential impacts on emissions reductions across options.
38. If policy decisions can be progressed prior to the General Election, officials consider that this pricing could be in place by 1 January 2025.
39. There are only twelve companies that manufacture or import synthetic fertilisers containing nitrogen and these companies are already required to report emissions under the CCRA. Nitrogen fertiliser emissions makes up six percent of agricultural emissions and include nitrous oxide and carbon dioxide emissions.
40. Pricing only fertiliser emissions creates a different profile of emissions obligations across agriculture sectors compared to pricing all agriculture emissions. This is due to some sectors (particularly dairy, horticulture and arable) making up a higher proportion of fertiliser emissions than total agriculture emissions.
41. A price on synthetic nitrogen fertiliser could be an interim measure and be folded into the farm level price or it could endure at the manufacturer and importer level beyond this. There two legislative options for pricing fertiliser at the manufacturer and importer-level, either:
 - impose NZ ETS surrender obligations on synthetic nitrogen fertiliser manufacturers and importers; or
 - impose a levy on synthetic nitrogen fertiliser manufacturers and importers for the expected on-farm nitrous oxide and carbon dioxide emissions arising from these fertilisers.

² Note that synthetic nitrogen fertiliser is either imported or manufactured domestically, it is not "processed" in the same way milk and meat is.

42. Both approaches will require some degree of legislative change and underpinning regulations to enact.
43. As mentioned above, the CCRA requires synthetic nitrogen fertiliser processors manufacturers and importers (and animals farmers) to pay for their emissions via the NZ ETS from 1 January 2025 (section 2A(5A) and (5D)). The level of allocation at 95 percent is also set in the CCRA (s 85). Legislative change would be required to include nitrogen fertiliser while deferring obligations for animals in the NZ ETS until the new pricing system is in place. Regulations will need to cover development of allocative baselines, emissions factors, reporting requirements and methodologies and compliance and enforcement along the lines of other NZ ETS regulations for other sectors.
44. For a levy, this would be legislated and could operate in a similar way to the synthetic greenhouse gas levy. All manufacturers and importers that currently report fertiliser emissions under the CCRA would be required to pay a levy on those emissions.
45. Under both legislative approaches decisions will be required on price setting and any free allocation. A fertiliser levy price could be set with reference to the NZ ETS price (as is currently done for the synthetic greenhouse gas levy³) or set as a unique price. The 95 percent free allocation currently in place for the NZ ETS backstop could be continued or amended as part of the legislative change mentioned above.
46. To give a sense of the revenue involved, if the levy price is tied to the NZ ETS (or if fertiliser emissions entered the NZ ETS), with a 95 percent free allocation phasing down 1 percentage point per year, this would raise \$7m in 2025 and \$9m⁴ in 2026. For farmers this would add around \$8 to the current urea cost of \$1,140 per tonne. Without the free allocation, the revenue raised, and additional cost will be twenty times higher and the emissions reductions possible from both the direct effect of the price on fertiliser and the use of revenue will be correspondingly higher.
47. Revenue raised from the fertiliser levy, or the share of NZ ETS auction revenue attributed to fertiliser could be used to incentivise emissions reductions. Funding could go towards areas such as payments for the uptake of mitigation practices and technologies and mitigation research and development.

Engaging with the sector and key stakeholders and consultation

48. The He Waka Eke Noa Partnership is currently awaiting an indication on Government's direction on pricing agricultural emissions. A number of other stakeholders have also asked for progress on this work following last year's public communications that policy decisions will be made in early 2023.

³ Synthetic Greenhouse Gas Levy places a price on the amount of synthetic GHG contained in items such as air conditioning units and motor vehicles

⁴ Using the NZ ETS price from New Zealand's Eighth National Communication which are \$68 and \$76 dollars per tonne CO₂e in 2025 and 2026.

49. It will be important to engage with key stakeholders, the He Waka Eke Noa Partnership, Treaty partners, and the public to provide certainty and direction on pricing agricultural emissions.

Next steps

50. We propose the following next steps to support development of the proposed policy package:

Week of 24 April 2023:

- i. Meet with officials to discuss this advice and the proposed process to agreeing policy decisions; and
- ii. Minister Shaw will receive advice on deferring obligations for animals-farmer activities under the NZ ETS.

May 2023: Officials provide you with advice to support decisions on key elements of a pricing system:

- i. proceeding with mandatory farm-level emissions measurement and reporting;
 - ii. recognising all scientifically valid sequestration in the NZ ETS, and the creation of a sequestration innovation pathway to support this, where this is practicable; and
 - iii. options for pricing synthetic nitrogen fertiliser at the processor-level.
51. Once officials have received direction on Ministers' preferred approach, we can develop policy detail to support Cabinet's decisions on legislation, and timeframes for each of the work programmes. Timeframes include legislation development, implementation (i.e., detailed business case, ICT build and piloting) and any consultation requirements as part of the legislative process.
 52. It is important that sector leaders are kept informed of any changes from last year's communications. We propose that Ministers meet with sector leaders to communicate direction of agricultural emissions pricing policy before public announcements are made.
 53. Ministers may also wish to discuss this with the Climate Change Commission, given they are proposed to play a key role in the agricultural emissions pricing system, as well as Treaty Partners who have a strong interest in the outcome of decisions on agricultural emissions pricing.
 54. Dependent on Cabinet's work programme, the latest date that Cabinet decisions could be made on any of these elements prior to the General Election is early August 2023.
 55. Officials note that Cabinet decisions on the final agricultural emissions pricing design [DEV-23-SUB-0052 /MPI AM23-0158 / MfE BRF-3043 refers] still need to occur. There are significant interdependencies between the design of the interim package and the final agricultural pricing system.