Priority – High **Security Level** – CLASSIFICATION

Ministry for Primary Industries
Manatū Ahu Matua

Ministry for the Environment
Manatū Mō Te Taiao

To: Hon Damien O'Connor, Minister of Agriculture
Hon James Shaw, Minister of Climate Change
From: Charlotte Denny, Director Natural Resources Policy
Sara Clarke, Director, Policy Implementation Division, MfE

Next steps on agricultural greenhouse gas emissions

Date	29 May 2023	**Reference**	B23-0385 BRF-3306

Decision required	Date decision required by
YES ☒ / NO ☐	30 May 2023

Purpose
This briefing seeks that Ministers: • provide feedback on the draft Cabinet paper; • initiate Ministerial consultation by 30 May; • lodge the Cabinet paper by 1 June; • support officials to continue to plan ahead within our current approved funding; • indicate preferred process to progress policy package; and • provide direction to officials regarding any support required for a public announcement.

Ministry for Primary Industries Contacts			
Name	**Position**	**Contact number**	**First contact**
Charlotte Denny	Director Natural Resources Policy	9(2)(a)	☒
Fleur Francois	Manager Climate Change On-Farm Mitigation and Inventory – Natural Resources Policy	9(2)(a)	

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Background

1. On 5 April, Cabinet Economic Development Committee considered a proposal to establish a farm-level agricultural emissions pricing system by 1 January 2025 [DEV-23-SUB-0052 refers]. The Committee agreed to defer decisions on the agricultural pricing system.

2. Subsequently, Ministers directed officials to work up an alternative package which takes a number of key steps towards pricing agricultural emissions in the future, including:
   a) mandatory farm-level reporting, where obligations are phased in potentially ahead of pricing;
   b) implementing an innovation pathway for recognition of on-farm sequestration; and
   c) pricing fertiliser emissions via a processor-level levy.

3. Attached is a draft Cabinet paper (**Appendix Five**) setting out the package for agreement as per your direction at the 17 May meeting between both Ministers, to pave the way for further discussions with He Waka Eke Noa partners.

4. Officials note you still have the option to progress:
   a) the proposed farm-level split-gas agriculture emissions pricing system as set out in the s215 report but with revised implementation dates; or
   b) mandatory farm-level reporting ahead of decisions on pricing.

Proposed timelines and process for progressing the Cabinet paper

5. To obtain Cabinet's agreement that Ministers can discuss the proposed policy package with Food and Fibre leaders and make any subsequent public announcement, the following timeline will need to be met.

Action	Date
Draft Cabinet paper (attached) is reviewed and finalised and sent to Ministers	29 May 2023
Ministerial consultation	30-31 May 2023
Lodge papers for DEV	1 June 2023
DEV meeting	7 June 2023
Cabinet approval	12 June 2023

6. Note that there has been no departmental consultation on the Cabinet paper outside of Treasury and the Department of the Prime Minister and Cabinet due to time constraints. Key feedback from Treasury is summarised below.

Summary of Treasury feedback

7. Treasury provided feedback on the draft Cabinet paper and requested further detail on aspects of the policy package. The feedback is summarised as follows:

Treasury feedback	Response
Concern that a public announcement amounts to a de facto policy decision by Cabinet, in the absence of public consultation and the requisite analysis.	Reframing the paper to seek in-principle agreement to informally discuss a range of options with the sector to avoid prematurely binding Cabinet to a particular policy direction.
Given the carbon removal strategy is in such a nascent stage, this paper feels like it's rushing publicising that direction before it has been considered by Cabinet.	Communication with the sector will not commit to the specifics of how this will be done or the timings for this.
Uncertainty around the proposed policy's emissions reducing effects. More clarity was requested on the climate targets that the proposed policy will/will not support and by how much. Feedback noted that the gross methane target is one of most at-risk of not being achieved through the proposal.	Text added to reflect methane target, particularly around the use of revenue for incentives.
More analysis would be useful on the preferred option of pricing fertiliser emissions via a levy at the processor-level. This includes signalling whether the option will transition to pricing emissions at the farm-level over time.	Text indicates that the aim is to move to emissions pricing over time, the form of which is yet to be decided.
Further clarity on how levy prices will be based on the average New Zealand Emissions Trading Scheme (NZ ETS) price and over what time period.	Average could mean the average over the last 12 months in a similar fashion to the Synthetic Greenhouse Gas levy, and text has been added to address this.
These proposals are a departure from proposals advanced during consultation run in 2022 and there would be risks if proper consultation processes are not followed.	Risk, and their mitigations are covered in the text.
Usage of levy revenue.	The revenue recycling strategy will determine this, and has yet to be developed.

Treasury feedback	Response
Treasury also identified that CIPA and RIS requirements will likely be triggered. They have flagged a significant risk if Government proposes policy direction without supporting analysis because there is no effective way to respond to sectoral assessments of impact.	Due to lack of time to complete these requirements a CIPA and RIS has not been provided. Supplementary analysis will be provided the next time Cabinet makes related decisions.

8. A Regulatory Impact Statement (RIS) has not been provided for this cabinet paper process, as it is not seeking to change legislation or regulations at this point. A RIS will be required for the next steps of progressing the policy package.

9. However, Treasury also noted that "*Cabinet's impact analysis requirements apply to this proposal regarding next steps on agriculture greenhouse gas emissions, but there is no accompanying Regulatory Impact Statement and the Treasury has not exempted the proposal from the impact analysis requirements. Therefore, it does not meet Cabinet's requirements for regulatory proposals. "*

10. The Treasury's Regulatory Impact Analysis team, the Ministry for Primary Industries (MPI) and the Ministry for the Environment (MfE) have agreed that supplementary analysis will be provided when Cabinet makes further policy decisions on this topic.

Implications of not addressing methane emissions now

11. The proposals in the attached draft Cabinet paper are a critical waypoint for addressing agricultural emissions in New Zealand, in combination with other initiatives the Government is putting in place such as investment in the Centre for Climate Action on Agriculture Emissions, additional resources for on-farm support, and integrated approach to farm planning. While the package above takes forward a number of key elements to reduce agricultural emissions in a staged approach, it doesn't address how to price methane emissions. Under this proposal this would come at a currently unknown date.

12. There are a number of possible implications associated with not taking more detailed decisions now on how to price methane emissions for Ministers to be aware of when taking these decisions, because they are likely to have flow on legal implications for meeting emissions budgets, under the Climate Change Response Act 2002 (CCRA).

13. The current Emissions Reduction Plan contains the action of pricing agricultural emissions from 1 January 2025.

14. 9(2)(h) Officials consider we have now passed the point in which we can deliver farm-level pricing by 1 January 2025. This creates a risk of a potential shortfall in achieving the second emissions budget and the 2030 Methane target (a 10 per cent reduction on 2017 levels by 2030). 9(2)(h)

[1] 9(2)(h)

9(2)(h)

15. In addition to the delay in pricing methane emissions, the regulatory uncertainty of not knowing what design the Government will choose to reduce methane emissions will also likely generate an inertia in action to reduce emissions, due to the continued uncertainty.

16. Both of these factors combined could mean it is harder to meet the second emissions budget and the 2030 target. The longer it takes to come back to the design details on how to price methane emissions the greater the risk of a potential shortfall in meeting the budgets and the target.

17. An option to minimise the risks above could be to go back to the s215 report design of reducing agricultural emissions with adjusted timeframes, or signal that the phased approach is a stepped-out way of getting there over time (for example, that Ministers are working towards ultimately landing on a design that aligns with the s215 framework).

18. Ministers also need to be aware that in going with the direction included in the draft Cabinet paper, it is likely to be viewed by the sector as the Crown breaking away from the sector agreed position on pricing agricultural emissions.

Pricing of fertiliser emissions via processor-level levy

19. Ministers agreed to progress a levy on emissions from fertiliser at the processor-level [MPI B23-0349; MfE BRF-3212 refers]. Ministers also indicated that levy prices could be based on the average New Zealand Emission Trading Scheme (NZ ETS) price for the first year[2]. After that, the Climate Change Commission could provide advice on unique levy rates.

20. Ministers requested further advice from officials on the potential impacts and unintended consequences from setting the levy at the full NZ ETS price.

21. The farm-level impacts vary across farms depending on the amount of fertiliser individual farms use. In the 12 case studies MPI provided to the Minister of Agriculture in AM23-0305, the impact on profitability ranged from 0.02 per cent for an apple orchard to 4.97 per cent for a South Island sheep and beef finishing farm.[3]

22. Arable and vegetable operations without livestock are effectively facing the full NZ ETS price for their emissions and may be at a disadvantage relative to dairy and sheep and beef farms that are only being priced on a small percentage of their emissions.[4]

[2] Average means the average over the last 12 months in a similar fashion to the Synthetic Greenhouse Gas levy.
[3] We are aware that Beef + Lamb NZ has estimated the impact of the fertiliser emission levy on sheep and beef farms, based on what we've seen, they have reached similar conclusions on impacts to officials – albeit there are differences between the farm class averages that Beef + Lamb NZ has used compared to official's specific case studies.
[4] Note that for some farms this proposal involves twenty times the impact of the farm levy proposal consulted on in October 2022.

23. There is potential for an unintended impact on land use change from arable or vegetable operations to dairy or sheep and beef as the fertiliser emissions levy does not price methane and livestock nitrous oxide emissions. If enough arable or vegetable operations convert to dairy or sheep and beef as a result of the fertiliser emissions levy, emissions could increase rather than decrease. Officials have not done modelling to test this.

24. New Zealand food prices increased by 12.5 per cent in the year to April 2023, the largest increase in the food price index since September 1987. Recent rises in fertiliser prices are cited as one driver of food price increases. Officials do not have quantitative analysis that disentangles fertiliser prices from other drivers of food price inflation such as fuel prices, wages, global food commodity prices, and levels of competition in New Zealand's grocery sector.

25. While a fertiliser levy may produce only minor impacts on food prices, consultation with those affected by the proposed levy could help to better understand any potential impacts and provide an ability to address them during policy design.

26. This levy on emissions from fertiliser is expected to raise $156 million in the 2026 calendar year. This estimate assumes a NZ ETS equivalent price of $75.60 per tonne CO_2e. See **Appendix Three** for more details.

27. Using this quantum of revenue could be challenging. Mitigation incentives are the largest expenditure item. Using assumptions from previous advice and a much lower level of operational administration costs reflecting mandatory reporting rather than a farm-level pricing scheme, gives a scheme surplus of between $60 million and $116 million in 2026. Under the most optimistic mitigation incentive uptake assumptions, around three quarters of the scheme revenue is expected to be used, this declines to 40 per cent under more pessimistic mitigation incentive uptake scenarios.

28. Once mitigation incentives are implemented (across all gases where mitigation options are available), emissions reductions from mitigation uptake could be similar under a fertiliser levy at processor-level compared to the earlier farm-level levy proposal. This use of the revenue could create significant across-sector fairness issues. However, due to time and data constraints, we have not modelled the overall emissions reductions we would expect from a fertiliser levy. We therefore cannot comment on whether a fertiliser levy overall would lead to similar emissions reductions compared to the farm-level levy.

Staged approach towards mandated farm-level reporting

29. Ministers have indicated they support a staged approach to pricing emissions through developing a mandatory farm emissions reporting framework. The first step would be developing and releasing a *standardised emissions calculation methodology* for farm-level reporting, as currently different methodologies and assumptions are used by the various calculators. This would be followed by *piloting the reporting framework*, that could be made mandatory in the future, and which would then be followed eventually by *emissions pricing*.

30. The pilot reporting stage could be introduced without legislation and would be used to test and iterate the reporting system with the sector.

31. There are several processes and systems that will need to be implemented along this path. In addition to the standards and methodology for reporting, as well as developing a registry and database would be required to record participant's information.

32. These can be designed to allow for future choices to be made as regarding the mandatory reporting and pricing approach. The design will also depend on policy choices made along the way. Options to leverage and align with existing Inland Revenue and/or Environmental Protection Agency (EPA) processes and systems will be considered during the design process.

33. Decisions will be needed to legislate the mandatory reporting stage, which can be further investigated and informed by the pilot phase. These include aspects such as:
    a) the implementation agency/agencies;
    b) definition of a participant, including complicated business structures and collectives;
    c) the requirements for data collection;
    d) auditing and enforcement powers; and
    e) timing for introduction of mandatory reporting.

34. This pilot reporting stage may achieve some limited emissions reductions behaviour. However, when the fertiliser levy funds become available, there is an option to link it to incentive payments for implementing mitigation opportunities in farm management to improve uptake of emissions reduction.

Next steps

35. Legislative decisions will be required to progress the agricultural emissions pricing package. Ministers have choices as to how this occurs. Officials are seeking direction on the timing of these decisions.

36. Currently the CCRA requires a wide range of animals-farmers to report their emissions with obligations coming into force on 1 January 2024. Part 5 of Schedule 3 of the CCRA requires participants carrying out the activity to report by 31 March 2025 for the year starting 1 January 2024 with surrender obligations from 1 January 2025. A system to support this requirement is not yet in place. In this case “participants” are a much wider group of farmers and growers (~50,000) than proposed under the current proposals and the EPA does not have the regulations and systems in place to implement this obligation. An Order in Council (OiC) process is needed to remove the obligations, including undertaking the legally required consultation.

37. A RIS will be required for the next steps of the policy package and officials will need to obtain additional information. This will enable analysis of the relatively high levy on fertiliser emissions discussed here as impacts may differ compared to the lower, broader levy proposed during the October 2022 consultation. The key gaps relate to the parts of the agriculture and horticulture sector that use more nitrogen fertiliser like arable and vegetable production, distributional impacts, and testing the potential for unintended consequences.

38. There are two possible approaches identified below (Option One and Two), which have pros and cons associated with them. Each option has implications for the implementation timeframes (indicative timeframes are outlined in **Appendix One** and **Appendix Two**).

*Option One – Progressing **post-election** with consultation*

39. Option One proposes final policy decisions on the policy package are taken post-election after public consultation in 2024. A draft indicative timeline for how this work programme could progress is included in **Appendix One**.

40. Under this option, the earliest pricing fertiliser emissions could be implemented is early 2026 subject to legislative processes and priority.

Pros

41. The pros for progressing post-election are identified below:
    a) would allow for public consultation to be undertaken to help understand any unintended consequences or impacts for Māori as Treaty Partners, and the sectors most likely affected; and
    b) would allow for more time for detailed design of primary legislation.

Cons

42. The cons for progressing post-election are identified below:
    a) it could be viewed as slowing down progress towards pricing agricultural emissions and meeting New Zealand's targets; and
    b) as an OiC should be completed prior to 1 January 2024 with consultation as required by law, this could not be progressed in time as part of the fertiliser policy decisions under this option and would be a stand-alone process.

Risk mitigations

43. Signalling Government's intentions and pathway forward to price agricultural emissions will be important to keep the sector and wider public aware of on-going work to meet New Zealand's targets.

44. Progressing the OiC to defer animals-farmer obligations, including consultation to meet legislative requirements, could occur prior to the election and stand on its own.

*Option Two – Progressing **pre-election** without consultation*

45. Option Two seeks final policy decisions without public consultation on the fertiliser levy pre-election. A draft indicative timeline for how this work programme could progress is included in **Appendix Two**. This would require further decisions by Cabinet in August 2023, including approval to issue drafting instructions for the fertiliser emissions levy.

46. This option does not include public consultation on primary legislation elements apart from during the Select Committee process. As the fertiliser levy component will require primary legislation, there is not a statutory requirement to consult. However, consultation is one mechanism through which the Government upholds its responsibility to act in good faith towards Māori. Additionally, failure to consult may result in legislation being passed without understanding fully the views and interests that may be relevant. This may result in difficulties applying and interpreting the legislation later.

47. Under this option, the earliest pricing fertiliser emissions could be implemented could be mid-2025 subject to legislative processes and priority.

Pros

48. The pros for progressing pre-election are identified below:
    a) it would provide policy certainty by ensuring that Cabinet approves a processor-level levy for fertiliser emissions prior to the election and would continue to signal the Government's commitment to progressing a system to price all agricultural emissions. The recent draft advice released by the Climate Change Commission reflected a need to advance the pricing of agricultural emissions to meet targets; and
    b) coupling the OiC with progressing a fertiliser processor-level levy would ensure that an avenue to price emissions is in train before signalling a deferral for animals-farmer participants. This would allow consultation on the OiC to defer animals-farmers obligations prior to the election to enable drafting and submission to Executive Council before 1 January 2024.

Cons

49. The cons for progressing pre-election are identified below:
    a) there is not enough time to undertake public consultation and detailed design on primary legislation pre-election. Note: this could have Treaty of Waitangi risk implications if engagement with Māori does not occur. The Crown is required to uphold the principles of the Treaty. This includes demonstrating that it took reasonable steps to understand the interests of affected Māori, the likely impact of the proposal, and any active steps the Crown should take to protect the affected interests of Māori. Given the extensive Māori interests in the agricultural sector, it will be important for the Crown to continue to involve Māori in the development of proposals. Consultation can be useful to understand Māori interests and impacts of the proposal, as well as continuing to facilitate Māori involvement. Māori submitters raised concerns about the process taken to uphold the Treaty principles of partnership and participation during the 2022 consultation on the proposed agricultural emissions pricing system; and

b) progressing too quickly may not allow for full consideration of all the consequences of the levy (see paragraphs 12 to 17 above), which may not have time to be resolved prior to the election. While there are no statutory obligations to consult, a lack of consultation could lead to legal implications with downstream consequences. For example, there could be a call for a judicial review or issues arising at Select Committee could delay the progress of the Bill especially if significant redrafting is required. In addition, the He Waka Eke Noa Partnership may have expectations of further public consultation as these proposals differ from those published in the s215 report in December 2022.

Risk mitigations

50. Engagement with Māori and targeted engagement, for example with fertiliser processors and particularly impacted groups will be important to uphold Treaty obligations and to help officials understand how to appropriately design the policy. Ongoing engagement with Māori and the sector is recommended to ensure that policy and regulations are fit for purpose, efficient and effective.

51. Consultation was undertaken last year on the proposed agricultural emissions pricing system, which enabled officials to understand some impacts of agricultural emissions pricing on Māori. This included options to price fertiliser at the processor level, amongst other options. Whilst the impacts of the proposed policy package are not the same as the impacts previously identified in the agricultural emissions pricing system proposed last year, officials have some understanding of the potential impacts that could arise when emissions linked to agriculture are priced.

52. Furthermore, effective public consultation on secondary legislation (i.e., levy prices) would also occur under this option.

Progressing implementation including developing further Business cases

53. The legislated changes required for mandatory reporting could be progressed post-election, with either of the options listed above. Once policy direction has been confirmed on reporting post-election, officials will provide a Programme Business Case for Cabinet's approval that summarises the end-to-end investment proposition, provides an achievable roadmap for delivery, and confirming it represents value for money. The Programme Business Case will confirm the case for change, aligned to our emissions targets and budgets.

54. We are seeking your support for officials to continue to plan ahead within our $13.2 million of funding approved in Budget 2023. Our current understanding of the envisaged system, pending your confirmation following discussions with sector leaders, is summarised in **Appendix Four**. Your support will allow a Detailed Business Case to be advanced for the pilot reporting stage.

55. Following your confirmation of the scope of the pilot reporting stage, the next steps would be (with tentative timing):
    a) **July to December 2023:** Sector engagement to standardise the emission calculation methodology, to confirm the impacts on existing sector calculator tools and systems, and to design the reporting framework to be piloted;
    b) **March 2024:** Detailed Business Case decision regarding the pilot reporting stage approach, cost and timing;
    c) **March to August 2024:** Alignment of sector calculators to the standardised methodology and establishment of the reporting framework, central registry and database; and
    d) **1 October 2024:** Pilot phase commences (to be confirmed).

Public announcement

56. There is a need to signal to the sector and public the direction being set for the pathway for the implementation of pricing agricultural emissions. The s215 report released last year, indicated that Cabinet would make final policy decisions on the agricultural emissions pricing system in early 2023, followed by legislation to give effect to those decisions.

57. There is a risk in announcing elements of the policy package before the policy has been developed and tested of ‘locking in’ a pathway. This may result in legal issues being identified when the policy is developed further.

58. If public consultation is agreed by Cabinet, the announcement of any decisions prior to this, has the risk of undermining that consultation, and could potentially demonstrate a level of pre-determination. This is particularly acute in relation to Treaty obligations.

59. The Cabinet paper sets out proposals and supporting material to enable a discussion with the sector.

60. There are choices as to how you might communicate the proposed policy package to the public including, for example, via press releases or a press conference. Officials can support Ministers with communications such as the drafting of supporting materials including a press release, FAQs and key messages or other materials as required.

61. The timing of any public announcement should be considered so that the information is relevant and timely for the sector and those most impacted by the decisions. Additionally, given that the Government signalled that there would be decisions made in early 2023, submitters to the consultation as well as the general public are likely to be expecting an announcement.

62. Officials seek your direction on how you would like to proceed with a public announcement in terms of the form and the timing of any communications.

Recommendations

63. It is recommended that you:

a) **Note** the uncertainty regarding potential unintended consequences of pricing fertiliser via processor-level levy due to lack of data.

NOTED

b) **Indicate** which process you wish to follow:

i. **Agree** to progress Option One- Final policy decisions on pricing fertiliser emissions via a processor-level levy post-election.

YES / NO

Or

ii. **Agree** to progress Option Two Final policy decisions on pricing fertiliser emissions via a processor-level levy pre-election.

YES / NO

c) **Indicate** your support for officials to continue to plan for the implementation of the pilot of farm-level emissions reporting within our current approved funding.

YES / NO

d) **Agree** to provide direction on desired communications approach and timing to publicly announce the key elements of the policy package.

YES / NO

9(2)(a)

Charlotte Denny
Director, Natural Resources Policy
Ministry for Primary Industries

Hon Damien O'Connor
Minister of Agriculture

/ / 2023

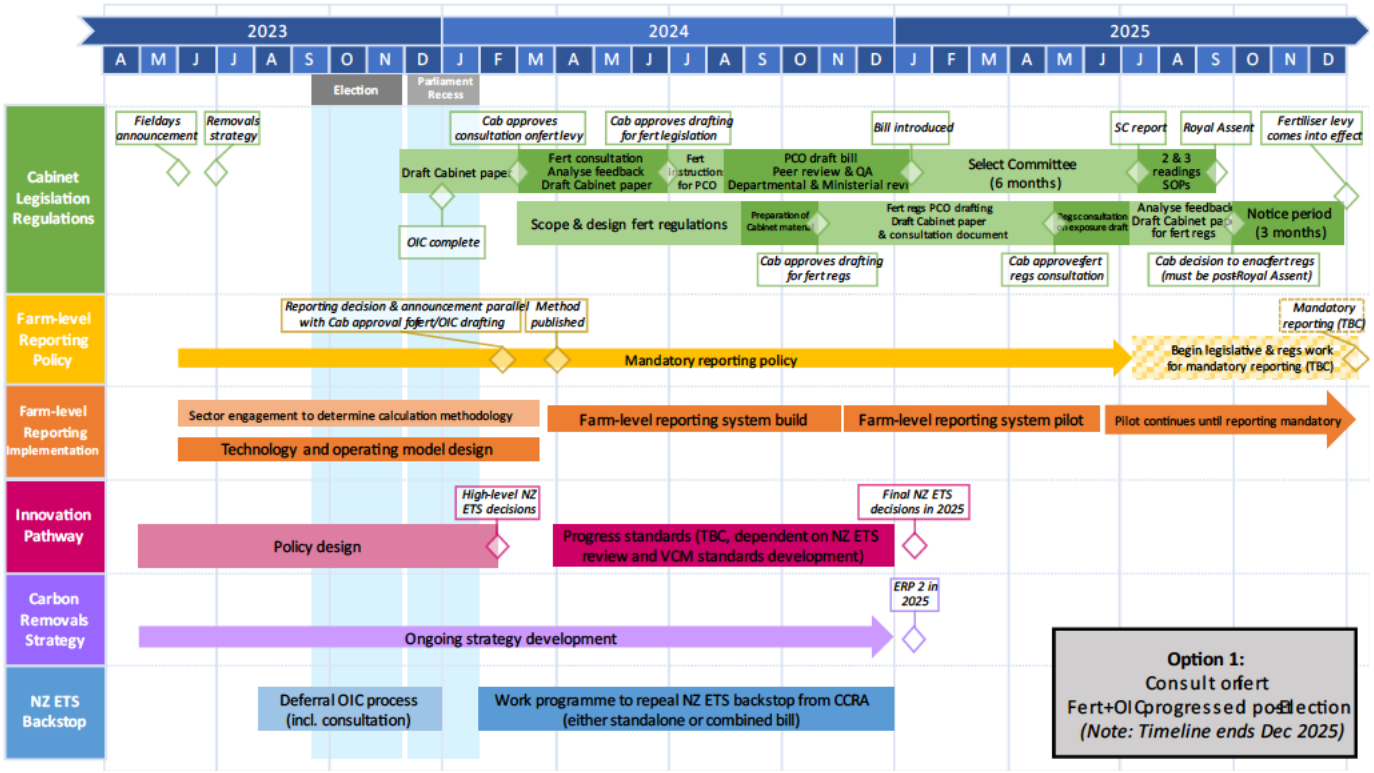
Sara Clarke
Director, Policy Implementation and Delivery
Ministry for the Environment

Hon James Shaw
Minister of Climate Change

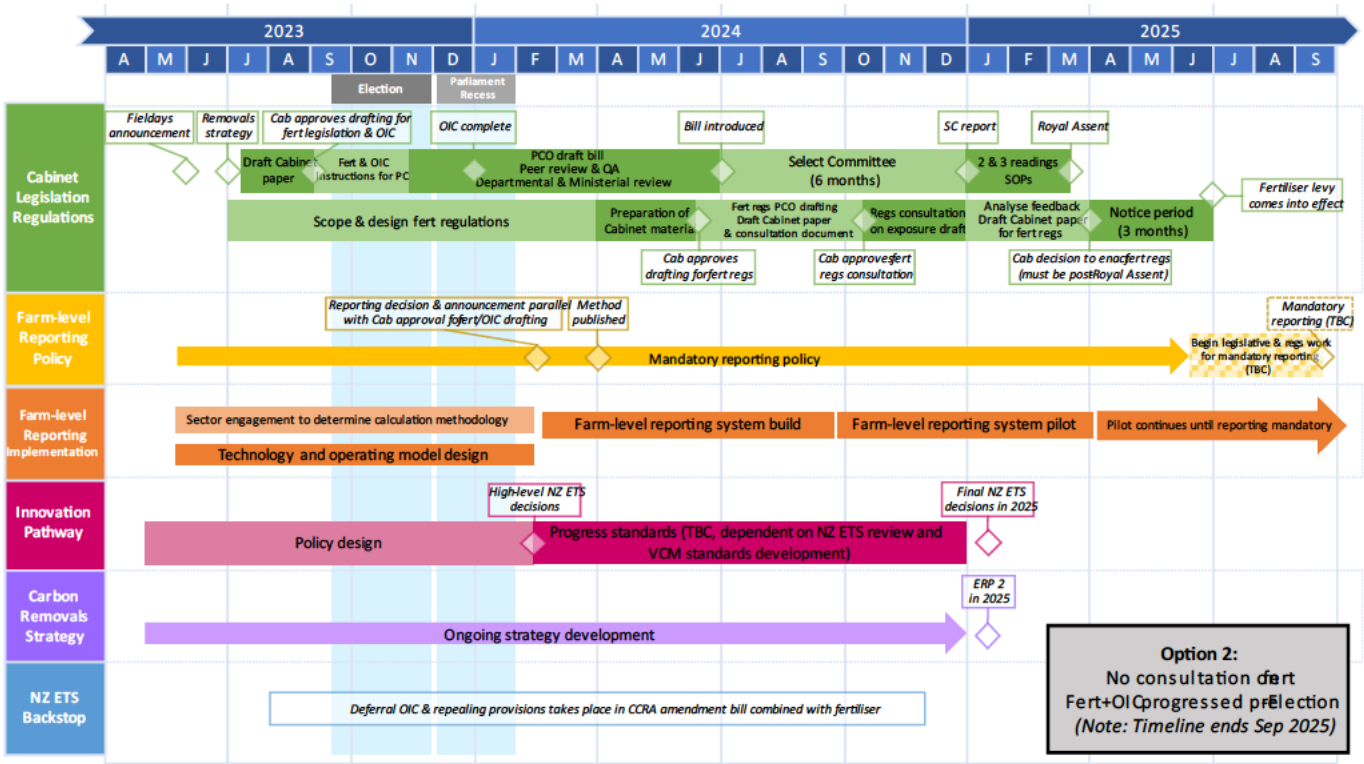
/ / 2023

Minister's comments

Appendix One: Option One- Draft indicative timeframe to progress post-election subject to decisions



Appendix Two: Option Two- Draft indicative timeframe to progress pre-election subject to decisions



Appendix Three: Nitrogen fertiliser emissions levy revenue and possible expenditure

	6 months from 1 July 2025	2026	2027
Revenue	**$70,804,283**	**$155,622,351**	**$70,892,945**
Assumed levy rate (equivalent to ETS price)	$ 68.06	$ 75.60	$ 83.81
Expenditure - Low mitigation uptake scenario			
Mitigation incentives (low uptake)	$ 4,921,686	$12,439,676	$15,253,342
Research and development	$ 5,321,252	$10,881,384	$11,099,012
Administration	$ 6,385,502	$13,057,661	$13,318,814
Māori landowners fund	$ 1,596,376	$ 3,264,415	$ 3,329,703
Total expenditure (low uptake)	$ 18,224,816	$39,643,136	$43,000,871
Scheme surplus or deficit (low uptake)	**$52,579,467**	**$115,979,21**	**$127,892,074**
Expenditure - High mitigation uptake scenario			
Mitigation incentives (high uptake)	$24,171,678	$68,030,459	$88,777,353
Research and development	$ 5,321,252	$ 10,881,384	$11,099,012
Administration	$ 6,385,502	$13,057,661	$13,318,814
Māori landowners fund	$ 1,596,376	$ 3,264,415	$ 3,329,703
Total expenditure (high uptake)	$37,474,808	$95,233,919	$116,524,881
Scheme surplus of deficit (high uptake)	**$33,329,475**	**$60,388,432**	**$54,368,064**

Appendix Four: Planning Assumption: Scope of Farm-Level Emissions Pilot Reporting

Component	Recommendation/options
Who participates?	• Approximately 23,000 GST-registered farm businesses that meet the defined thresholds as presented in the s215 report, are eligible to participate in the pilot phase.
Which emissions gases and sources?	• Methane and nitrous oxide from dairy, beef, sheep and deer livestock. • Nitrous oxide and carbon dioxide from synthetic fertilisers.
How are emissions calculated?	• Standards-based approach to implementing a consistent methodology across multiple emissions calculators provided within the sector.
Reporting process	• Centralised registry and database of participants and their emissions "returns". • Returns/declarations required on an annual basis, aligned to the business's accounting period. • Consider in the design alignment to EPA and/or IR systems for future farm-level pricing options.
Mitigations	• Mitigations are to be reflected in the calculation and reporting process. • Further investigation during pilot to determine linkages to mitigation financial incentives.
Excluded from pilot phase:	• Reporting on a collective basis (to be further investigated during pilot). • Sequestration (out of scope of this programme).

Appendix Five: Draft Cabinet paper

CLASSIFICATION

Cabinet Paper Sign Out Sheet

Sign out sheet

	Who	***Date***
Title and Tracking number:	CAB-271	
Date Due for Lodging:		1/06/2023
Analyst/Drafter(s):	Mele Tabukovu Shannon Bentley Angela Christensen Hannah Steans	18/05/2023
Legal review: *(If applicable)*	Francesca Williams Heather Hay	19/05/2023 25/05/2023
Peer review:	Hamish Slack Darran Austin	19/05/2023
Proof read completed:		
Manager sign out:	Kara Lok Fleur Francois	18/5/2023 19/5/2023 23/5/2023
Director sign out:	Sara Clarke Charlotte Denny	23/5/2023
Deputy Secretary sign out:	Janine Smith Julie Collins	24/05/2023

Please complete this Cabinet Paper Sign-Out Sheet. This sheet should accompany <u>all</u> Cabinet paper versions that are going to be put in front of the Minister for comment.

Policy and Privacy

In-Confidence

Office of the Minister of Agriculture

Office of the Minister of Climate Change

DEV - Cabinet Economic Development Committee

Next steps on agricultural greenhouse gas emissions

Proposal

1 This paper seeks Cabinet's in-principle agreement on a proposed agricultural emissions policy package to support informal discussions with the Food and Fibre Leaders at Fieldays 2023.

Relation to government priorities

2 The Government declared a climate change emergency on 2 December 2020. The Cabinet Business Committee (CBC) agreed that climate change "demands a sufficiently ambitious, urgent, and coordinated response across government to meet the scale and complexity of the challenge" [CBC-20-MIN-0097 refers].

3 Reductions in agricultural emissions are required to slow the rate at which Aotearoa New Zealand contributes to climate change. The amount that agricultural emissions need to reduce is expressed via:

3.1 Aotearoa New Zealand's Nationally Determined Contributions (NDC) set under the Paris Agreement[1];

3.2 The domestic reductions targets laid out in the Climate Change Response Act (CCRA)[2]; and

3.3 The agricultural sub-budgets set in the domestic emissions budgets agreed by Cabinet [CAB-22-MIN-0152].

4 The proposals in this paper relate to the Cooperation Agreement between the Labour and Green Parties. Achieving the purpose and goals of the 2019 zero

[1] Aotearoa New Zealand has committed to an updated NDC under the Paris Agreement of a 50 per cent reduction of net emissions below our gross 2005 level by 2030. NDC1 does not distinguish between greenhouse gases.

[2] The CCRA contains the following domestic emissions reduction targets:
- Net zero greenhouse gas emissions (other than biogenic methane) by 2050;
- Reduction of biogenic methane by 10 per cent below 2017 levels by 2030; and 24-47 per cent by 2050.

carbon amendments to the Climate Change Response Act 2002 (CCRA) is an agreed area of cooperation.

Executive Summary

5 Pricing agricultural emissions remains the top priority in incentivising emissions reductions from the agricultural sector in line with our domestic and international emissions reduction targets. While we remain committed to pricing all agricultural emissions, we propose a phased approach is taken to achieving this.

6 Working with the sector is a key part of establishing an enduring system to reduce agricultural emissions. For the past four years, we have worked hard alongside the sector to balance the need for sector buy-in while ensuring we develop a robust system that helps meet our climate change goals.

7 This paper seeks Cabinet's agreement to informally discuss with the Food and Fibre Leaders' and publicly announce Government's proposal on an agricultural emissions policy package. This policy package builds on previous government announcements on agricultural emissions and consists of:

7.1 Mandatory farm-level agricultural emissions reporting, where obligations to comply with a reporting framework are phased in. This will follow the development and release of a standardised emissions calculation methodology and a pilot of the reporting framework to refine this process with the sector; and

7.2 Pricing fertiliser emissions via a processor-level levy, where -

7.2.1 manufacturers and importers of synthetic nitrogen fertiliser face a levy on nitrous oxide and carbon dioxide emissions;

7.2.2 in the first year, the levy price could be an average of the New Zealand Emissions Trading Scheme (NZ ETS) price;

7.2.3 levy revenue will initially cover administration costs and then be recycled back to the sector. A revenue recycling strategy will outline how the remaining funds could be used to further incentivise emissions reductions.

7.3 Eligible sequestration would not be managed through a farm-level emissions pricing system before being recognised in the NZ ETS. Instead, the Government is developing a Carbon Removal Strategy that will impact the recognition of sequestration such as the NZ ETS and voluntary carbon markets.

8 As part of the Carbon Removal Strategy, we propose to discuss at a high level with the sector, developing an Innovation Pathway to incentivise private research for new removal activities, such as on-farm sequestration. Further work is needed to explore the Pathway, including the gaps and opportunities in current government support and assessing current legal and regulatory frameworks.

Background

He Waka Eke Noa – Primary Sector Climate Action Partnership was established to develop an alternative system to price agricultural emissions

9 Agriculture[3] contributes to 49 percent of Aotearoa New Zealand's greenhouse gas emissions. The agriculture sector therefore plays an important part in meeting our domestic (including our gross methane target) and international emissions reduction targets.

10 In 2019, Government agreed to work with the Food and Fibre Leaders on the He Waka Eke Noa – Primary Sector Climate Action Partnership (the Partnership) to design an alternative pricing system to agriculture entering the New Zealand Emissions Trading Scheme (NZ ETS)[4].

11 In 2022, Government received recommendations from the Partnership, advice from the Climate Change Commission (the Commission) and over 21,000 submissions during public consultation on a farm-level levy.

12 Following public consultation, we worked with the Food and Fibre Leaders to refine the pricing system. In December 2022, we released a report under section 215 of the CCRA that detailed a system to price agricultural emissions as an alternative to the NZ ETS. The system was based on a farm-level split-gas levy designed to assist in reducing emissions in line with Aotearoa New Zealand's emissions reduction targets and maintain a viable and productive agriculture sector.

13 The proposed alternative farm-level pricing system would have included approximately 23,000 farmers and growers, which is approximately 96 per cent of the agriculture sector's emissions. The system included the following core features:

13.1 agricultural emissions (biogenic methane and nitrous oxide) would be priced differently, with separate levy rates;

13.2 payments would be available for the uptake of incentives and eligible sequestration;

13.3 revenue raised from the levy would be recycled back to the sector; and

13.4 the Climate Change Commission would advise Cabinet on levy rates after consultation with an Oversight Board (comprised of expertise from the agricultural sector and Māori).

[3] Mention of the agriculture sector in this paper encompasses the horticulture sector, as per the NZ Greenhouse Gas Inventory reporting methodology.
[4] The Food and Fibre Leader's Forum consists of Beef and Lamb NZ (B+LNZ), DairyNZ, Horticulture NZ, Federated Farmers, Apiculture NZ, the Federation of Māori Authorities, Foundation for Arable Research, Fonterra, Deer Industry NZ, Meat Industry Association and Irrigation NZ. The Forum is chaired by Mike Petersen.

14 The section 215 report was accompanied by a press release on 21 December 2022 outlining Government's intentions for a farm-level levy from 20255. This built upon a press release from 30 November 2022 outlining a sequestration strategy work programme with the sector[6].

15 On 5 April, Cabinet Economic Development Committee considered a proposal to establish a farm-level agricultural emissions pricing system by 1 January 2025 [DEV-23-SUB-0052 refers]. The Committee agreed to defer decisions on the agricultural emissions pricing system.

16 We acknowledge there are unique circumstances for agriculture that mean we need more time to ensure the design of the full agricultural pricing system is fit for purpose. Therefore, we are proposing to phase components of the pricing system to support the agricultural sector contribute to Aotearoa New Zealand's emissions reduction targets.

Approach to reducing agricultural emissions

We remain committed to pricing agricultural emissions.

17 Pricing agricultural emissions remains the top priority in incentivising emissions reductions from the agriculture sector in line with our emissions reduction targets. While we remain committed to pricing all agricultural emissions, we propose a phased approach is taken to achieving this. We propose to progress work on developing the following policy package, that builds on the 2022 Government announcements:

17.1 A phased approach to implementing a mandatory farm-level reporting system that supports farmers and growers to consistently estimate and report their on-farm greenhouse gas emissions. The mandatory reporting system will start with the development of a standardised calculation methodology and a pilot of the reporting framework;

17.2 Pricing synthetic nitrogen fertiliser emissions in a levy at the processor-level (i.e., fertiliser manufacturers and importers); and

17.3 For carbon sequestration, as a part of the carbon removals strategy[7], an Innovation Pathway is proposed to be discussed at a high-level with the sector as further work is needed to explore this Pathway.

Engaging with the Food and Fibre Leaders is an important step in ensuring sector buy-in and developing an enduring system

18 Working with the sector is a key part of establishing an enduring system to reduce agricultural emissions. For the past four years, we have worked hard

[5] https://www.beehive.govt.nz/release/govt-and-industry-take-next-step-agriculture-emissions-reduction-plan.
[6] https://www.beehive.govt.nz/release/government-sets-out-next-steps-farm-sequestration-strategy
[7] The Minister of Climate Change intends to present a paper to Cabinet on the carbon removals strategy in July 2023.

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alongside the sector to balance the need for sector buy-in while ensuring we develop a robust system that helps meet our emissions reduction targets.

19 Therefore, we seek Cabinet's agreement to discuss the Government's intent to progress work on key elements of this proposed policy package with the Food and Fibre Leaders at Fieldays on June 14 – 17.

20 The proposed approach aligns with recent commentary from some sector partners calling for Government to phase-in the agricultural emissions pricing system. This is because the proposed approach helps reduce some of the complexity and uncertainty of the system.

Mandatory farm-level agricultural emissions reporting

Background

21 Under Schedule 5 of the CCRA, the Partnership has committed to supporting 100 per cent of farmers and growers measure emissions on farm through the "know your number" farm-level reporting milestone by 31 December 2022.

22 In their latest update (May 2023), the Partnership reported that 81 per cent of farmers and growers had completed their once-off calculation of on-farm emissions using one of the 11 calculators the Partnership endorsed.

23 While the Partnership endorsed these calculators, there are different methodologies and assumptions used within the calculators and therefore inconsistencies in the emissions calculated. Furthermore, these emissions calculations outputs are not then reported, collected or stored, and are the methodology or assumptions are not publicly available.

Proposals for discussion with the sector

24 A reporting framework that is robust, transparent, consistent, and cost-effective for both the sector and Government is a crucial underpinning of a farm-level pricing system.

25 We are seeking your in-principle agreement to discuss with the sector the introduction of mandatory farm-level emissions reporting which includes the following staged approach to implementation:

25.1 starting with developing and releasing a standardised emissions calculation methodology for farm-level reporting;

25.2 then piloting of the reporting framework to refine the process and system with the sector; and

25.3 followed by mandatory farm-level reporting using the farm level reporting methodology, ahead of the commencement of any full agricultural emissions pricing system.

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26 This staged approach would provide an opportunity for farmers and growers to provide feedback and enable improvements to be made before regulating the reporting methodology, and later, a full agricultural emissions pricing system.

27 To support implementation of the mandatory farm-level emissions reporting we could consider data interoperability options as part of the systems data framework. This would allow alignment with other regulatory systems, access to existing farm level system data to be standardised. This would reduce the administrative burden for farmers and growers.

Pricing fertiliser emissions

Background

28 Manufacturers and importers of synthetic nitrogen fertiliser already report emissions to the Environmental Protection Authority (EPA). As part of the legislative backstop for pricing agricultural emissions, processor-level participants will have to surrender NZ ETS units for these emissions from 1 January 2025, unless this obligation is repealed.

29 Application of synthetic nitrogen fertiliser causes nitrous oxide emissions and in the case of urea, both nitrous oxide and carbon dioxide emissions. Six percent of agricultural emissions (equal to 2.25 Mt CO2e annually) come from synthetic nitrogen fertiliser.

30 Between 1991 and 2019, it is estimated that nitrogen fertiliser application increased around 600 percent reflecting an increase in dairy farming. However, fertiliser use has declined in the last 12 months which can largely be attributed to fertiliser price increases and reforms in freshwater policy. Further work is still needed to decrease emissions from fertiliser.

Proposals for discussion with the sector

31 We are seeking your in-principle agreement to discuss with the sector, pricing synthetic nitrogen fertiliser emissions via a processor-level levy in advance of a full agricultural emissions pricing system.

32 There is often a lag between changes in price and associated changes in quantity demanded for fertiliser. Therefore, a levy can incentivise emissions reductions from nitrogen fertiliser due to a price on emissions, and through the investment of levy revenue back into the sector. Introduction of a processor-levy for fertiliser emissions could also support the intent to shift to a full agricultural emissions pricing system in the future.

33 To support this, we propose to discuss the following points with Food and Fibre Leaders on pricing fertiliser emissions:

33.1 manufacturers and importers of synthetic nitrogen fertiliser could face a levy on nitrous oxide and carbon dioxide emissions;

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33.2 organic fertiliser, lime and dolomite could be excluded from the levy as it is not practical to price emissions from these fertilisers at a processor-levy[8];

33.3 for the first year, the levy prices could be based on the average NZ ETS price (this is the average of the full NZ ETS price without any discounts / free allocation). Estimates suggest, this could be $64 per tonne of CO_2e in 2025[9]. For subsequent years, depending on the design of the full agricultural emissions pricing system, the Climate Change Commission could provide advice on the unique levy rates[10];

33.4 revenue could be used to cover the levy system administration costs and to support further emissions reductions within the agricultural sector. A revenue recycling strategy could be developed in consultation with the sector to prioritise how the remaining revenue could be spent. The strategy could include investment in research and development, incentive payments for emissions mitigation technologies, and any other priorities, which could include transitional support for disproportionately impacted sectors.

Options for progressing the fertiliser levy

34 We currently have different views on how to best progress the fertiliser levy and we seek Cabinet's direction on timeframes to progress the levy:

34.1 Option 1: we could publicly consult in 2024 to inform the detailed design of the levy prior to Cabinet decisions on approval to draft primary legislation [Minister of Agriculture's preferred option].

34.2 Option 2: we could work on detailed design of the levy now and get Cabinet's approval to draft primary legislation ahead of the 2023 General Election. This would mean the public would be consulted during the Select Committee process in 2024 [Minister of Climate Change's preferred option].

35 Option 1 would align with good regulatory practices and support Government's understanding on impacts and any unintended consequences on affected stakeholders. This is important because the proposed policy package is different to what was consulted on in 2022 and therefore will likely have different impacts. Effective consultation to make informed decisions also supports acting in good faith towards Māori and supports the Crown meet its Te Tiriti obligation.

[8] Organic fertiliser, lime and dolomite have numerous suppliers (including a farm itself) which would add additional complexity to the levy.

[9] The methodology for deriving the levy price from the average NZ ETS price is subject to detailed policy decisions but could follow the Synthetic Greenhouse Gas (SGG) levy methodology of using the average carbon price over the previous financial year. In the last five years the SGG levy price has been 2023 - $67.63; 2022 - $36.50; 2021 - $25.60; 2020 - $24.54; 2019 - $19.88. New Zealand's Eighth National Communication modelling suggest the NZ ETS price could be $64.

[10] In developing advice on unique prices, the Commission could consider factors such as alignment to achieving emissions reductions and social, cultural and economic impacts.

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This option would also allow for more time for detailed design of primary legislation.

36 However, this option may be perceived as slowing down progress towards pricing agricultural emissions and meeting Aotearoa New Zealand's emissions reduction targets. Government could signal their intentions and the pathway forward to pricing agricultural emissions and ongoing work to meet Aotearoa New Zealand's emission reduction targets to mitigate this risk during any discussions and announcements.

37 Option 2 would support policy certainty and signal the Government's commitment to progressing a system to price agricultural emissions. It also aligns with the Commission's recent draft advice which reflected a need to advance the pricing of agricultural emissions to meet our emissions reduction targets. By getting approval to draft primary legislation in 2023, the levy could be in place sooner than in Option 2.

38 However, there is not enough time to progress detailed policy design and public consultation ahead of the 2023 General Election. Public consultation supports Government to uphold Te Tiriti o Waitangi and consideration of the full consequences of a policy. However, engagement with Māori and the agricultural sector could mitigate this risk and extensive consultation on pricing agricultural emissions was carried out in 2019 and 2022[11].

Sequestration

Background

39 In late 2022, Government announced that, at a minimum, sequestration from riparian margins and management of indigenous vegetation would be recognised within the farm-levy system in 2025. Government also announced it would work with the primary sector to develop a joint sequestration strategy to support recognition of more forms of sequestration.

40 However, there have been significant challenges with respect to reaching consensus on recognising on-farm sequestration, including:

40.1 recognising sequestration placed significant fiscal pressure on the farm-level pricing system;

40.2 the high cost of recognising and mapping small areas of vegetation that often have low sequestration potential; and,

40.3 equity challenges between sub-sectors.

Proposals for discussion with the sector

[11] Note that previous consultation was not on the exact form of pricing proposed in this paper (i.e., a processor-level levy solely on fertiliser manufacturers and importers).

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41 The Government has multiple related work programmes on carbon removals underway that will impact recognition of sequestration including the Carbon Removals Strategy, the NZ ETS review, voluntary carbon markets, MaxCarbon, biodiversity incentives and New Zealand's international emissions accounting changes.

42 There are key dependencies in these work programmes, for example the Carbon Removals Strategy will provide the overarching strategy, but the policy levers sit within the NZ ETS (which is influenced by the outcomes of the NZ ETS review), voluntary carbon markets, biodiversity incentives and all potential future markets. Therefore, Cabinet decisions on these work programmes need to be aligned.

43 An Innovation Pathway is one component of the broader Carbon Removal Strategy. Further work is needed to explore the Pathway, including the gaps and opportunities in current government support and assessing current legal and regulatory frameworks. Policy decisions will be needed to approve the Carbon Removal Strategy and Innovation Pathway. We propose to discuss this at a high level with the sector as part of the package.

Treaty of Waitangi considerations

44 Iwi/Māori have significant interests in agribusiness and forestry, through both investment and settlement assets, with 32 per cent of Māori businesses being in the food and fibre sector.[12]

45 The Federation of Māori Authorities is a member of the Food and Fibre Leaders and therefore will be involved in the discussions at Fieldays. The potential high-level implications of the package are:

45.1 Pricing synthetic fertiliser emissions could affect Māori investments, assets and interests in different ways and may further increase barriers to the development of whenua Māori by diverting money into the levy.

45.2 Mandatory farm-level reporting could have an increased administrative burden on Māori agribusiness and landowners due to ownership and management structures.

45.3 During public consultation on farm-level pricing, Māori stated they wanted the ability to offset their emissions using on-farm carbon sequestration. The innovation pathway may increase barriers to recognition by placing the onus of further research requirements on Māori (and other interested parties) prior to these categories getting recognition. However, to the extent that research is carried out, Māori landowners and agribusiness would benefit from any increased opportunities for recognition of on-farm sequestration.

[12] Ministry for Primary Industries. 2022. Māori primary sector Plan- Rautaki mo te Taurikura: Embracing change for prosperity. Retrieved from https://www.mpi.govt.nz/dmsdocument/54376 (Accessed 30 January 2023).

46 It is important to carry out further engagement with Māori to support further understanding of potential impacts of this package on Māori agribusiness and landowners. This could occur as part of public consultation or as targeted consultation alongside detailed policy development for primary legislation. There will be further opportunities for consultation on secondary legislation.

Financial and Legislative Implications

47 There are no financial and legislative implications of this paper. However, there are associated implications in future to implement this policy package.

48 Implementing an agricultural emission pricing scheme is a significant investment that would need to follow the Treasury's Better Business Case guidance. A Programme Business Case (PBC) is required and will be followed by appropriate business cases for individual initiatives and/or tranches within the programme, following Cabinet policy decisions.

49 The associated future legislative implications include:

49.1 The synthetic fertiliser emissions levy and mandatory farm-level emissions reporting system will require either amendments to the Climate Change Response Act (CCRA) or the establishment of a new piece of legislation.

49.2 To enable the recognition of new forms of removal in the NZ ETS as part of the innovation pathway, the CCRA may need to be amended. For example, sections 162 and 168 could be modified to create new regulation-making powers to recognise new removal activities.

NZ ETS Backstop

50 The CCRA[13] contains a list of agricultural activities that require persons undertaking them to become NZ ETS participants (known as the NZ ETS backstop). However, these obligations apply at different times for different activities (see Table 2).

[13] Schedule 3, Part 5

Table 2: Agricultural activities that mandate NZ ETS participation

Activity	NZ ETS obligations
Animals (processor) Slaughtering ruminant animals, pigs, horses, or poultry Dairy processing of milk or colostrum Exporting from New Zealand live cattle, sheep, or pigs	Reporting obligations have applied since 1 January 2011 Obligations to surrender units for emissions currently apply for emissions from 1 January 2025 (unless animals-farmer participant surrender obligations commence)
Fertiliser (processor) Importing or manufacturing synthetic fertilisers containing nitrogen.	Reporting obligations have applied since 1 January 2011 Obligations to surrender units for emissions currently apply from 1 January 2025 (unless fertiliser-farmer participant surrender obligations commence)
Animals (farmer) Farming, raising, growing, or keeping ruminant animals, pigs, horses, or poultry for reward, or for the purpose of trade in those animals.	Reporting obligations apply from 1 January 2024, or a later date appointed by Order in Council Obligations to surrender units for emissions would apply for emissions from 1 January 2025 (one year following reporting obligations).
Fertiliser (farmer) Purchasing, other than for on-selling, synthetic fertiliser containing nitrogen for application to land.	Reporting obligations apply from a date appointed by Order in Council Obligations to surrender units for emissions would apply one year after reporting obligations start.

51 Under current provisions of the CCRA, agricultural emissions pricing via the NZ ETS will take effect from 1 January 2025. Animals farmer reporting obligations also come into force on 1 January 2024.

52 To implement the proposed pricing system, the Government would need to defer animal-farmer reporting obligations through an Order in Council this year and then pass new legislation and repeal the relevant provisions in the CCRA [Minister of Climate Change direction is that this happens alongside legislative amendments for the fertiliser levy].

Impact Analysis

53 A regulatory impact statement (RIS) and Climate Implications of Policy Assessment (CIPA) have not been provided. A RIS and CIPA will be required to support final policy decisions on the elements within this package.

Population Implications

54 While there are no immediate implications to the discussions associated with this paper, if the proposals are implemented, they could have the following population implications.

Impacts on agricultural sub-sectors

55 The farm level impacts vary across farms depending on the amount of fertiliser individual farms use. For example, at a levy price of $64 per tonne CO_2e[14], urea would increase in price by 15 per cent, and we expect a decrease in fertiliser sales by between 7.5 and 15 per cent.

56 Officials assessed the impacts of $64 per tonne levy price on 12 case studies and found that the impact on profitability ranged from 0.02 per cent for an apple orchard to 4.97 per cent for a South Island sheep and beef finishing farm.

57 Arable and vegetable operations without livestock are effectively facing the full NZ ETS price for their emissions, compared to the current context where they face no price on their agricultural emissions. This proposal involves twenty times the impact of the farm levy proposal consulted on in October 2022 as that proposal featured 95 per cent free allocation for fertiliser emissions.

58 There is potential for an unintended impact on land use change from arable or vegetable operations to dairy or sheep and beef as the fertiliser emissions levy does not price methane and livestock nitrous oxide emissions. If enough arable or vegetable operations convert to dairy or sheep and beef as a result of the fertiliser emissions levy, emissions could increase rather than decrease. Officials have not done modelling to test this.

Impacts on food prices

59 New Zealand food prices increased by 12.5 per cent in the year to April 2023, the largest increase in the food price index since September 1987. Recent rises in fertiliser prices are cited as one driver of food price increases. Officials do not have quantitative analysis that disentangles fertiliser prices from other drivers of food price inflation such as fuel prices, wages, global food commodity prices, and levels of competition in New Zealand's grocery sector.

60 While a fertiliser levy may produce only minor impacts on food prices, we do not have a strong evidence base to quantify these impacts. Public consultation on the proposed levy could help to better understand any potential impacts and unintended consequences.

61 To mitigate some of the impacts, some revenue could be used as transitional support for disproportionately impacted sectors.

62 In addition, extension services and farm support services (e.g., farm advisors and accountants) are likely to be integral in supporting the successful implementation of mandatory farm-level reporting. Via the rollout of the freshwater farm plan system, the farm advisory workforce is being ramped up with $25 million of funding announced in 2022. There is an opportunity for this workforce to also provide farmers advice on how to understand and manage their on-farm emissions.

[14] The Eighth National Communication modelled NZ ETS price in 2025.

Projected environmental impacts

63 As emissions from fertiliser are just six per cent of agricultural emissions, any impact on New Zealand's overall emissions will be significantly smaller than a system that prices all of agriculture's emissions profile, including potentially having less impact on meeting our 2030 gross methane target.

64 Research has shown that fertiliser sales change over time proportionally to changes in fertiliser price[15][16][OBJ]. Therefore, we expect that the amount of fertiliser sold in New Zealand would decrease if a price was placed on fertiliser emissions (see paragraph 55). However, this may take two to five years to occur.

65 Furthermore, the revenue from the levy could further incentivise emissions reductions through investment in research and development or incentivising emissions reductions behaviour on-farm.

66 A high price on fertiliser may have cascading impacts. As nitrogen fertiliser increases pasture growth, it supports more emissions-intensive farming approaches. If the price on fertiliser emissions is high, then farmers may reduce application of synthetic nitrogen fertiliser which may lead to a reduction in their stocking rates or increase in their use of imported feeds (such as Palm Kernel Extract). Ongoing monitoring would be beneficial in case of perverse substitution outcomes.

67 Any reduction in nitrogen fertiliser use will also provide co-benefits in assisting the achievement of freshwater outcomes given nitrogen fertiliser is also a contributor to nitrate loads in our freshwater environments.

Human Rights

68 We anticipate the proposals in this paper will be consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993. Further analysis will be carried out as detailed policy proposals are developed.

Consultation

69 Te Tai Ōhanga|The Treasury and the Department of the Prime Minister and Cabinet were consulted on this paper.

Communications

70 We intend to discuss the matters outlined in this paper at a meeting with Food and Fibre Leaders at Fieldays 2023 on 14 – 17 June. Public communications will follow.

[15] Austin, Darran, Kay Cao, and Gerald Rys. *Modelling nitrogen fertiliser demand in New Zealand*. No. 1164-2016-93144. 2006

[16] Breen, J. P., Clancy, D., Donnellan, T., & Hanrahan, K. F. (2012). *Estimating the elasticity of demand and the production response for nitrogen fertiliser on Irish Farms* (No. 354-2016-18144).

71 There are risks to publicly announcing Government's intention to progress the proposed policy package before final Cabinet decisions are made. These risks include:

71.1 pre-empting Cabinet decisions on policy detail;

71.2 'locking in' policy direction before the policy has been thoroughly developed and tested and consulted or engaged on; and

71.3 consultation and Treaty risks due to the perception that policy decisions have been predetermined before public consultation or targeted engagement.

Proactive Release

72 Following Cabinet consideration, we intend to consider the release of this paper on the Ministry for the Environment website in whole or in part, subject to redactions.

Recommendations

73 The Minister of Agriculture and Minister of Climate Change recommends that the Committee:

1 **Note** if public announcement on policy ahead of stakeholder engagement and Cabinet decisions on detailed policy design.

2 **Note** that the Climate Change Response Act 2022 would need to be amended to repeal the NZ ETS legislative backstop for agriculture if the policy package in this paper is progressed.

3 **Agree** to discuss with the Food and Fibre Leaders the proposal to introduce mandatory farm-level agricultural emissions reporting including the following staged approach to implementation:

3.1 starting with developing and releasing a standardised emissions calculation methodology for farm-level reporting;

3.2 then, piloting a reporting framework to refine the process and system with the sector; and

3.3 followed by mandatory reporting using the farm level reporting methodology, ahead of the commencement of any full agricultural emissions pricing system.

4 **Agree** to discuss with Food and Fibre leaders the proposal to price fertiliser emissions at the processor-level including the following components:

4.1 manufacturers and importers of synthetic nitrogen fertiliser face a levy on nitrous oxide and carbon dioxide emissions;

4.2 organic fertiliser, lime and dolomite are excluded from the levy;

4.3 for the first year, the levy prices could be based on the average NZ ETS price. For subsequent years, the Climate Change Commission could provide advice on the unique levy rates; and

4.4 revenue is used to cover levy system administration costs, and to support further emissions reductions within the agricultural sector. A revenue recycling strategy could be developed in consultation with the sector to prioritise how the revenue could be spent, including on research and development, incentive payments for emissions mitigation technologies, and any other priorities.

5 EITHER:

5.1 **Agree** to publicly consult in 2024 prior to getting Cabinet approval to draft primary legislation [Minister of Agriculture's preferred option].

OR:

5.2 **Invite** Ministers to report back to Cabinet in August 2023 for approval to draft primary legislation, with public consultation to occur as part of Select Committee processes [Minister of Climate Change's preferred option].

6 **Agree** to discuss with Food and Fibre Leaders that:

6.1 the Government has multiple related work programmes on carbon removals underway that will impact recognition of sequestration including the Carbon Removals Strategy, the NZ ETS review, voluntary carbon markets, MaxCarbon, biodiversity incentives and New Zealand's international emissions accounting changes.

1.a as part of the Carbon Removal Strategy, we propose to discuss at a high-level with the sector an Innovation Pathway. Further work is needed to explore the Pathway, including the gaps and opportunities in current government support and assessing current legal and regulatory frameworks.

7 **Agree** to publicly announce that discussions with the agriculture sector are underway on the proposals outlined in recommendations 2 – 6 following discussions with the Food and Fibre Leaders.

Authorised for lodgement

Hon Damien O'Connor

Minister of Agriculture

Hon James Shaw

Minister of Climate Change

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Cabinet Paper Sign Out Sheet

Sign out sheet

	Who	***Date***
Title and Tracking number:	CAB-271	
Date Due for Lodging:		1/06/2023
Analyst/Drafter(s):	Mele Tabukovu Shannon Bentley Angela Christensen Hannah Steans	18/05/2023
Legal review: *(If applicable)*	Francesca Williams Heather Hay	19/05/2023 25/05/2023
Peer review:	Hamish Slack Darran Austin	19/05/2023
Proof read completed:		
Manager sign out:	Kara Lok Fleur Francois	18/5/2023 19/5/2023 23/5/2023
Director sign out:	Sara Clarke Charlotte Denny	23/5/2023
Deputy Secretary sign out:	Janine Smith Julie Collins	24/05/2023

Please complete this Cabinet Paper Sign-Out Sheet. This sheet should accompany <u>all</u> Cabinet paper versions that are going to be put in front of the Minister for comment.

Policy and Privacy

In-Confidence

Office of the Minister of Agriculture

Office of the Minister of Climate Change

DEV - Cabinet Economic Development Committee

Next steps on agricultural greenhouse gas emissions

Proposal

1 This paper seeks Cabinet's in-principle agreement on a proposed agricultural emissions policy package to support informal discussions with the Food and Fibre Leaders at Fieldays 2023.

Relation to government priorities

2 The Government declared a climate change emergency on 2 December 2020. The Cabinet Business Committee (CBC) agreed that climate change "demands a sufficiently ambitious, urgent, and coordinated response across government to meet the scale and complexity of the challenge" [CBC-20-MIN-0097 refers].

3 Reductions in agricultural emissions are required to slow the rate at which Aotearoa New Zealand contributes to climate change. The amount that agricultural emissions need to reduce is expressed via:

3.1 Aotearoa New Zealand's Nationally Determined Contributions (NDC) set under the Paris Agreement[1];

3.2 The domestic reductions targets laid out in the Climate Change Response Act (CCRA)[2]; and

3.3 The agricultural sub-budgets set in the domestic emissions budgets agreed by Cabinet [CAB-22-MIN-0152].

4 The proposals in this paper relate to the Cooperation Agreement between the Labour and Green Parties. Achieving the purpose and goals of the 2019 zero

[1] Aotearoa New Zealand has committed to an updated NDC under the Paris Agreement of a 50 per cent reduction of net emissions below our gross 2005 level by 2030. NDC1 does not distinguish between greenhouse gases.

[2] The CCRA contains the following domestic emissions reduction targets:
- Net zero greenhouse gas emissions (other than biogenic methane) by 2050;
- Reduction of biogenic methane by 10 per cent below 2017 levels by 2030; and 24-47 per cent by 2050.

carbon amendments to the Climate Change Response Act 2002 (CCRA) is an agreed area of cooperation.

Executive Summary

5 Pricing agricultural emissions remains the top priority in incentivising emissions reductions from the agricultural sector in line with our domestic and international emissions reduction targets. While we remain committed to pricing all agricultural emissions, we propose a phased approach is taken to achieving this.

6 Working with the sector is a key part of establishing an enduring system to reduce agricultural emissions. For the past four years, we have worked hard alongside the sector to balance the need for sector buy-in while ensuring we develop a robust system that helps meet our climate change goals.

7 This paper seeks Cabinet's agreement to informally discuss with the Food and Fibre Leaders' and publicly announce Government's proposal on an agricultural emissions policy package. This policy package builds on previous government announcements on agricultural emissions and consists of:

7.1 Mandatory farm-level agricultural emissions reporting, where obligations to comply with a reporting framework are phased in. This will follow the development and release of a standardised emissions calculation methodology and a pilot of the reporting framework to refine this process with the sector; and

7.2 Pricing fertiliser emissions via a processor-level levy, where -

7.2.1 manufacturers and importers of synthetic nitrogen fertiliser face a levy on nitrous oxide and carbon dioxide emissions;

7.2.2 in the first year, the levy price could be an average of the New Zealand Emissions Trading Scheme (NZ ETS) price;

7.2.3 levy revenue will initially cover administration costs and then be recycled back to the sector. A revenue recycling strategy will outline how the remaining funds could be used to further incentivise emissions reductions.

7.3 Eligible sequestration would not be managed through a farm-level emissions pricing system before being recognised in the NZ ETS. Instead, the Government is developing a Carbon Removal Strategy that will impact the recognition of sequestration such as the NZ ETS and voluntary carbon markets.

8 As part of the Carbon Removal Strategy, we propose to discuss at a high level with the sector, developing an Innovation Pathway to incentivise private research for new removal activities, such as on-farm sequestration. Further work is needed to explore the Pathway, including the gaps and opportunities in current government support and assessing current legal and regulatory frameworks.

Background

He Waka Eke Noa – Primary Sector Climate Action Partnership was established to develop an alternative system to price agricultural emissions

9 Agriculture[3] contributes to 49 percent of Aotearoa New Zealand's greenhouse gas emissions. The agriculture sector therefore plays an important part in meeting our domestic (including our gross methane target) and international emissions reduction targets.

10 In 2019, Government agreed to work with the Food and Fibre Leaders on the He Waka Eke Noa – Primary Sector Climate Action Partnership (the Partnership) to design an alternative pricing system to agriculture entering the New Zealand Emissions Trading Scheme (NZ ETS)[4].

11 In 2022, Government received recommendations from the Partnership, advice from the Climate Change Commission (the Commission) and over 21,000 submissions during public consultation on a farm-level levy.

12 Following public consultation, we worked with the Food and Fibre Leaders to refine the pricing system. In December 2022, we released a report under section 215 of the CCRA that detailed a system to price agricultural emissions as an alternative to the NZ ETS. The system was based on a farm-level split-gas levy designed to assist in reducing emissions in line with Aotearoa New Zealand's emissions reduction targets and maintain a viable and productive agriculture sector.

13 The proposed alternative farm-level pricing system would have included approximately 23,000 farmers and growers, which is approximately 96 per cent of the agriculture sector's emissions. The system included the following core features:

13.1 agricultural emissions (biogenic methane and nitrous oxide) would be priced differently, with separate levy rates;

13.2 payments would be available for the uptake of incentives and eligible sequestration;

13.3 revenue raised from the levy would be recycled back to the sector; and

13.4 the Climate Change Commission would advise Cabinet on levy rates after consultation with an Oversight Board (comprised of expertise from the agricultural sector and Māori).

[3] Mention of the agriculture sector in this paper encompasses the horticulture sector, as per the NZ Greenhouse Gas Inventory reporting methodology.
[4] The Food and Fibre Leader's Forum consists of Beef and Lamb NZ (B+LNZ), DairyNZ, Horticulture NZ, Federated Farmers, Apiculture NZ, the Federation of Māori Authorities, Foundation for Arable Research, Fonterra, Deer Industry NZ, Meat Industry Association and Irrigation NZ. The Forum is chaired by Mike Petersen.

14 The section 215 report was accompanied by a press release on 21 December 2022 outlining Government's intentions for a farm-level levy from 20255. This built upon a press release from 30 November 2022 outlining a sequestration strategy work programme with the sector[6].

15 On 5 April, Cabinet Economic Development Committee considered a proposal to establish a farm-level agricultural emissions pricing system by 1 January 2025 [DEV-23-SUB-0052 refers]. The Committee agreed to defer decisions on the agricultural emissions pricing system.

16 We acknowledge there are unique circumstances for agriculture that mean we need more time to ensure the design of the full agricultural pricing system is fit for purpose. Therefore, we are proposing to phase components of the pricing system to support the agricultural sector contribute to Aotearoa New Zealand's emissions reduction targets.

Approach to reducing agricultural emissions

We remain committed to pricing agricultural emissions.

17 Pricing agricultural emissions remains the top priority in incentivising emissions reductions from the agriculture sector in line with our emissions reduction targets. While we remain committed to pricing all agricultural emissions, we propose a phased approach is taken to achieving this. We propose to progress work on developing the following policy package, that builds on the 2022 Government announcements:

17.1 A phased approach to implementing a mandatory farm-level reporting system that supports farmers and growers to consistently estimate and report their on-farm greenhouse gas emissions. The mandatory reporting system will start with the development of a standardised calculation methodology and a pilot of the reporting framework;

17.2 Pricing synthetic nitrogen fertiliser emissions in a levy at the processor-level (i.e., fertiliser manufacturers and importers); and

17.3 For carbon sequestration, as a part of the carbon removals strategy[7], an Innovation Pathway is proposed to be discussed at a high-level with the sector as further work is needed to explore this Pathway.

Engaging with the Food and Fibre Leaders is an important step in ensuring sector buy-in and developing an enduring system

18 Working with the sector is a key part of establishing an enduring system to reduce agricultural emissions. For the past four years, we have worked hard

[5] https://www.beehive.govt.nz/release/govt-and-industry-take-next-step-agriculture-emissions-reduction-plan.
[6] https://www.beehive.govt.nz/release/government-sets-out-next-steps-farm-sequestration-strategy
[7] The Minister of Climate Change intends to present a paper to Cabinet on the carbon removals strategy in July 2023.

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alongside the sector to balance the need for sector buy-in while ensuring we develop a robust system that helps meet our emissions reduction targets.

19 Therefore, we seek Cabinet's agreement to discuss the Government's intent to progress work on key elements of this proposed policy package with the Food and Fibre Leaders at Fieldays on June 14 – 17.

20 The proposed approach aligns with recent commentary from some sector partners calling for Government to phase-in the agricultural emissions pricing system. This is because the proposed approach helps reduce some of the complexity and uncertainty of the system.

Mandatory farm-level agricultural emissions reporting

Background

21 Under Schedule 5 of the CCRA, the Partnership has committed to supporting 100 per cent of farmers and growers measure emissions on farm through the "know your number" farm-level reporting milestone by 31 December 2022.

22 In their latest update (May 2023), the Partnership reported that 81 per cent of farmers and growers had completed their once-off calculation of on-farm emissions using one of the 11 calculators the Partnership endorsed.

23 While the Partnership endorsed these calculators, there are different methodologies and assumptions used within the calculators and therefore inconsistencies in the emissions calculated. Furthermore, these emissions calculations outputs are not then reported, collected or stored, and are the methodology or assumptions are not publicly available.

Proposals for discussion with the sector

24 A reporting framework that is robust, transparent, consistent, and cost-effective for both the sector and Government is a crucial underpinning of a farm-level pricing system.

25 We are seeking your in-principle agreement to discuss with the sector the introduction of mandatory farm-level emissions reporting which includes the following staged approach to implementation:

25.1 starting with developing and releasing a standardised emissions calculation methodology for farm-level reporting;

25.2 then piloting of the reporting framework to refine the process and system with the sector; and

25.3 followed by mandatory farm-level reporting using the farm level reporting methodology, ahead of the commencement of any full agricultural emissions pricing system.

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26 This staged approach would provide an opportunity for farmers and growers to provide feedback and enable improvements to be made before regulating the reporting methodology, and later, a full agricultural emissions pricing system.

27 To support implementation of the mandatory farm-level emissions reporting we could consider data interoperability options as part of the systems data framework. This would allow alignment with other regulatory systems, access to existing farm level system data to be standardised. This would reduce the administrative burden for farmers and growers.

Pricing fertiliser emissions

Background

28 Manufacturers and importers of synthetic nitrogen fertiliser already report emissions to the Environmental Protection Authority (EPA). As part of the legislative backstop for pricing agricultural emissions, processor-level participants will have to surrender NZ ETS units for these emissions from 1 January 2025, unless this obligation is repealed.

29 Application of synthetic nitrogen fertiliser causes nitrous oxide emissions and in the case of urea, both nitrous oxide and carbon dioxide emissions. Six percent of agricultural emissions (equal to 2.25 Mt CO2e annually) come from synthetic nitrogen fertiliser.

30 Between 1991 and 2019, it is estimated that nitrogen fertiliser application increased around 600 percent reflecting an increase in dairy farming. However, fertiliser use has declined in the last 12 months which can largely be attributed to fertiliser price increases and reforms in freshwater policy. Further work is still needed to decrease emissions from fertiliser.

Proposals for discussion with the sector

31 We are seeking your in-principle agreement to discuss with the sector, pricing synthetic nitrogen fertiliser emissions via a processor-level levy in advance of a full agricultural emissions pricing system.

32 There is often a lag between changes in price and associated changes in quantity demanded for fertiliser. Therefore, a levy can incentivise emissions reductions from nitrogen fertiliser due to a price on emissions, and through the investment of levy revenue back into the sector. Introduction of a processor-levy for fertiliser emissions could also support the intent to shift to a full agricultural emissions pricing system in the future.

33 To support this, we propose to discuss the following points with Food and Fibre Leaders on pricing fertiliser emissions:

33.1 manufacturers and importers of synthetic nitrogen fertiliser could face a levy on nitrous oxide and carbon dioxide emissions;

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33.2 organic fertiliser, lime and dolomite could be excluded from the levy as it is not practical to price emissions from these fertilisers at a processor-levy[8];

33.3 for the first year, the levy prices could be based on the average NZ ETS price (this is the average of the full NZ ETS price without any discounts / free allocation). Estimates suggest, this could be $64 per tonne of CO_2e in 2025[9]. For subsequent years, depending on the design of the full agricultural emissions pricing system, the Climate Change Commission could provide advice on the unique levy rates[10];

33.4 revenue could be used to cover the levy system administration costs and to support further emissions reductions within the agricultural sector. A revenue recycling strategy could be developed in consultation with the sector to prioritise how the remaining revenue could be spent. The strategy could include investment in research and development, incentive payments for emissions mitigation technologies, and any other priorities, which could include transitional support for disproportionately impacted sectors.

Options for progressing the fertiliser levy

34 We currently have different views on how to best progress the fertiliser levy and we seek Cabinet's direction on timeframes to progress the levy:

34.1 Option 1: we could publicly consult in 2024 to inform the detailed design of the levy prior to Cabinet decisions on approval to draft primary legislation [Minister of Agriculture's preferred option].

34.2 Option 2: we could work on detailed design of the levy now and get Cabinet's approval to draft primary legislation ahead of the 2023 General Election. This would mean the public would be consulted during the Select Committee process in 2024 [Minister of Climate Change's preferred option].

35 Option 1 would align with good regulatory practices and support Government's understanding on impacts and any unintended consequences on affected stakeholders. This is important because the proposed policy package is different to what was consulted on in 2022 and therefore will likely have different impacts. Effective consultation to make informed decisions also supports acting in good faith towards Māori and supports the Crown meet its Te Tiriti obligation.

[8] Organic fertiliser, lime and dolomite have numerous suppliers (including a farm itself) which would add additional complexity to the levy.

[9] The methodology for deriving the levy price from the average NZ ETS price is subject to detailed policy decisions but could follow the Synthetic Greenhouse Gas (SGG) levy methodology of using the average carbon price over the previous financial year. In the last five years the SGG levy price has been 2023 - $67.63; 2022 - $36.50; 2021 - $25.60; 2020 - $24.54; 2019 - $19.88. New Zealand's Eighth National Communication modelling suggest the NZ ETS price could be $64.

[10] In developing advice on unique prices, the Commission could consider factors such as alignment to achieving emissions reductions and social, cultural and economic impacts.

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This option would also allow for more time for detailed design of primary legislation.

36 However, this option may be perceived as slowing down progress towards pricing agricultural emissions and meeting Aotearoa New Zealand's emissions reduction targets. Government could signal their intentions and the pathway forward to pricing agricultural emissions and ongoing work to meet Aotearoa New Zealand's emission reduction targets to mitigate this risk during any discussions and announcements.

37 Option 2 would support policy certainty and signal the Government's commitment to progressing a system to price agricultural emissions. It also aligns with the Commission's recent draft advice which reflected a need to advance the pricing of agricultural emissions to meet our emissions reduction targets. By getting approval to draft primary legislation in 2023, the levy could be in place sooner than in Option 2.

38 However, there is not enough time to progress detailed policy design and public consultation ahead of the 2023 General Election. Public consultation supports Government to uphold Te Tiriti o Waitangi and consideration of the full consequences of a policy. However, engagement with Māori and the agricultural sector could mitigate this risk and extensive consultation on pricing agricultural emissions was carried out in 2019 and 2022[11].

Sequestration

Background

39 In late 2022, Government announced that, at a minimum, sequestration from riparian margins and management of indigenous vegetation would be recognised within the farm-levy system in 2025. Government also announced it would work with the primary sector to develop a joint sequestration strategy to support recognition of more forms of sequestration.

40 However, there have been significant challenges with respect to reaching consensus on recognising on-farm sequestration, including:

40.1 recognising sequestration placed significant fiscal pressure on the farm-level pricing system;

40.2 the high cost of recognising and mapping small areas of vegetation that often have low sequestration potential; and,

40.3 equity challenges between sub-sectors.

Proposals for discussion with the sector

[11] Note that previous consultation was not on the exact form of pricing proposed in this paper (i.e., a processor-level levy solely on fertiliser manufacturers and importers).

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41 The Government has multiple related work programmes on carbon removals underway that will impact recognition of sequestration including the Carbon Removals Strategy, the NZ ETS review, voluntary carbon markets, MaxCarbon, biodiversity incentives and New Zealand's international emissions accounting changes.

42 There are key dependencies in these work programmes, for example the Carbon Removals Strategy will provide the overarching strategy, but the policy levers sit within the NZ ETS (which is influenced by the outcomes of the NZ ETS review), voluntary carbon markets, biodiversity incentives and all potential future markets. Therefore, Cabinet decisions on these work programmes need to be aligned.

43 An Innovation Pathway is one component of the broader Carbon Removal Strategy. Further work is needed to explore the Pathway, including the gaps and opportunities in current government support and assessing current legal and regulatory frameworks. Policy decisions will be needed to approve the Carbon Removal Strategy and Innovation Pathway. We propose to discuss this at a high level with the sector as part of the package.

Treaty of Waitangi considerations

44 Iwi/Māori have significant interests in agribusiness and forestry, through both investment and settlement assets, with 32 per cent of Māori businesses being in the food and fibre sector.[12]

45 The Federation of Māori Authorities is a member of the Food and Fibre Leaders and therefore will be involved in the discussions at Fieldays. The potential high-level implications of the package are:

45.1 Pricing synthetic fertiliser emissions could affect Māori investments, assets and interests in different ways and may further increase barriers to the development of whenua Māori by diverting money into the levy.

45.2 Mandatory farm-level reporting could have an increased administrative burden on Māori agribusiness and landowners due to ownership and management structures.

45.3 During public consultation on farm-level pricing, Māori stated they wanted the ability to offset their emissions using on-farm carbon sequestration. The innovation pathway may increase barriers to recognition by placing the onus of further research requirements on Māori (and other interested parties) prior to these categories getting recognition. However, to the extent that research is carried out, Māori landowners and agribusiness would benefit from any increased opportunities for recognition of on-farm sequestration.

[12] Ministry for Primary Industries. 2022. Māori primary sector Plan- Rautaki mo te Taurikura: Embracing change for prosperity. Retrieved from https://www.mpi.govt.nz/dmsdocument/54376 (Accessed 30 January 2023).

46 It is important to carry out further engagement with Māori to support further understanding of potential impacts of this package on Māori agribusiness and landowners. This could occur as part of public consultation or as targeted consultation alongside detailed policy development for primary legislation. There will be further opportunities for consultation on secondary legislation.

Financial and Legislative Implications

47 There are no financial and legislative implications of this paper. However, there are associated implications in future to implement this policy package.

48 Implementing an agricultural emission pricing scheme is a significant investment that would need to follow the Treasury's Better Business Case guidance. A Programme Business Case (PBC) is required and will be followed by appropriate business cases for individual initiatives and/or tranches within the programme, following Cabinet policy decisions.

49 The associated future legislative implications include:

49.1 The synthetic fertiliser emissions levy and mandatory farm-level emissions reporting system will require either amendments to the Climate Change Response Act (CCRA) or the establishment of a new piece of legislation.

49.2 To enable the recognition of new forms of removal in the NZ ETS as part of the innovation pathway, the CCRA may need to be amended. For example, sections 162 and 168 could be modified to create new regulation-making powers to recognise new removal activities.

NZ ETS Backstop

50 The CCRA[13] contains a list of agricultural activities that require persons undertaking them to become NZ ETS participants (known as the NZ ETS backstop). However, these obligations apply at different times for different activities (see Table 2).

[13] Schedule 3, Part 5

Table 2: Agricultural activities that mandate NZ ETS participation

Activity	NZ ETS obligations
Animals (processor) Slaughtering ruminant animals, pigs, horses, or poultry Dairy processing of milk or colostrum Exporting from New Zealand live cattle, sheep, or pigs	Reporting obligations have applied since 1 January 2011 Obligations to surrender units for emissions currently apply for emissions from 1 January 2025 (unless animals-farmer participant surrender obligations commence)
Fertiliser (processor) Importing or manufacturing synthetic fertilisers containing nitrogen.	Reporting obligations have applied since 1 January 2011 Obligations to surrender units for emissions currently apply from 1 January 2025 (unless fertiliser-farmer participant surrender obligations commence)
Animals (farmer) Farming, raising, growing, or keeping ruminant animals, pigs, horses, or poultry for reward, or for the purpose of trade in those animals.	Reporting obligations apply from 1 January 2024, or a later date appointed by Order in Council Obligations to surrender units for emissions would apply for emissions from 1 January 2025 (one year following reporting obligations).
Fertiliser (farmer) Purchasing, other than for on-selling, synthetic fertiliser containing nitrogen for application to land.	Reporting obligations apply from a date appointed by Order in Council Obligations to surrender units for emissions would apply one year after reporting obligations start.

51 Under current provisions of the CCRA, agricultural emissions pricing via the NZ ETS will take effect from 1 January 2025. Animals farmer reporting obligations also come into force on 1 January 2024.

52 To implement the proposed pricing system, the Government would need to defer animal-farmer reporting obligations through an Order in Council this year and then pass new legislation and repeal the relevant provisions in the CCRA [Minister of Climate Change direction is that this happens alongside legislative amendments for the fertiliser levy].

Impact Analysis

53 A regulatory impact statement (RIS) and Climate Implications of Policy Assessment (CIPA) have not been provided. A RIS and CIPA will be required to support final policy decisions on the elements within this package.

Population Implications

54 While there are no immediate implications to the discussions associated with this paper, if the proposals are implemented, they could have the following population implications.

Impacts on agricultural sub-sectors

55 The farm level impacts vary across farms depending on the amount of fertiliser individual farms use. For example, at a levy price of $64 per tonne CO_2e[14], urea would increase in price by 15 per cent, and we expect a decrease in fertiliser sales by between 7.5 and 15 per cent.

56 Officials assessed the impacts of $64 per tonne levy price on 12 case studies and found that the impact on profitability ranged from 0.02 per cent for an apple orchard to 4.97 per cent for a South Island sheep and beef finishing farm.

57 Arable and vegetable operations without livestock are effectively facing the full NZ ETS price for their emissions, compared to the current context where they face no price on their agricultural emissions. This proposal involves twenty times the impact of the farm levy proposal consulted on in October 2022 as that proposal featured 95 per cent free allocation for fertiliser emissions.

58 There is potential for an unintended impact on land use change from arable or vegetable operations to dairy or sheep and beef as the fertiliser emissions levy does not price methane and livestock nitrous oxide emissions. If enough arable or vegetable operations convert to dairy or sheep and beef as a result of the fertiliser emissions levy, emissions could increase rather than decrease. Officials have not done modelling to test this.

Impacts on food prices

59 New Zealand food prices increased by 12.5 per cent in the year to April 2023, the largest increase in the food price index since September 1987. Recent rises in fertiliser prices are cited as one driver of food price increases. Officials do not have quantitative analysis that disentangles fertiliser prices from other drivers of food price inflation such as fuel prices, wages, global food commodity prices, and levels of competition in New Zealand's grocery sector.

60 While a fertiliser levy may produce only minor impacts on food prices, we do not have a strong evidence base to quantify these impacts. Public consultation on the proposed levy could help to better understand any potential impacts and unintended consequences.

61 To mitigate some of the impacts, some revenue could be used as transitional support for disproportionately impacted sectors.

62 In addition, extension services and farm support services (e.g., farm advisors and accountants) are likely to be integral in supporting the successful implementation of mandatory farm-level reporting. Via the rollout of the freshwater farm plan system, the farm advisory workforce is being ramped up with $25 million of funding announced in 2022. There is an opportunity for this workforce to also provide farmers advice on how to understand and manage their on-farm emissions.

[14] The Eighth National Communication modelled NZ ETS price in 2025.

Projected environmental impacts

63 As emissions from fertiliser are just six per cent of agricultural emissions, any impact on New Zealand's overall emissions will be significantly smaller than a system that prices all of agriculture's emissions profile, including potentially having less impact on meeting our 2030 gross methane target.

64 Research has shown that fertiliser sales change over time proportionally to changes in fertiliser price[15][16][OBJ]. Therefore, we expect that the amount of fertiliser sold in New Zealand would decrease if a price was placed on fertiliser emissions (see paragraph 55). However, this may take two to five years to occur.

65 Furthermore, the revenue from the levy could further incentivise emissions reductions through investment in research and development or incentivising emissions reductions behaviour on-farm.

66 A high price on fertiliser may have cascading impacts. As nitrogen fertiliser increases pasture growth, it supports more emissions-intensive farming approaches. If the price on fertiliser emissions is high, then farmers may reduce application of synthetic nitrogen fertiliser which may lead to a reduction in their stocking rates or increase in their use of imported feeds (such as Palm Kernel Extract). Ongoing monitoring would be beneficial in case of perverse substitution outcomes.

67 Any reduction in nitrogen fertiliser use will also provide co-benefits in assisting the achievement of freshwater outcomes given nitrogen fertiliser is also a contributor to nitrate loads in our freshwater environments.

Human Rights

68 We anticipate the proposals in this paper will be consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993. Further analysis will be carried out as detailed policy proposals are developed.

Consultation

69 Te Tai Ōhanga|The Treasury and the Department of the Prime Minister and Cabinet were consulted on this paper.

Communications

70 We intend to discuss the matters outlined in this paper at a meeting with Food and Fibre Leaders at Fieldays 2023 on 14 – 17 June. Public communications will follow.

[15] Austin, Darran, Kay Cao, and Gerald Rys. *Modelling nitrogen fertiliser demand in New Zealand*. No. 1164-2016-93144. 2006

[16] Breen, J. P., Clancy, D., Donnellan, T., & Hanrahan, K. F. (2012). *Estimating the elasticity of demand and the production response for nitrogen fertiliser on Irish Farms* (No. 354-2016-18144).

71 There are risks to publicly announcing Government's intention to progress the proposed policy package before final Cabinet decisions are made. These risks include:

71.1 pre-empting Cabinet decisions on policy detail;

71.2 'locking in' policy direction before the policy has been thoroughly developed and tested and consulted or engaged on; and

71.3 consultation and Treaty risks due to the perception that policy decisions have been predetermined before public consultation or targeted engagement.

Proactive Release

72 Following Cabinet consideration, we intend to consider the release of this paper on the Ministry for the Environment website in whole or in part, subject to redactions.

Recommendations

73 The Minister of Agriculture and Minister of Climate Change recommends that the Committee:

1 **Note** if public announcement on policy ahead of stakeholder engagement and Cabinet decisions on detailed policy design.

2 **Note** that the Climate Change Response Act 2022 would need to be amended to repeal the NZ ETS legislative backstop for agriculture if the policy package in this paper is progressed.

3 **Agree** to discuss with the Food and Fibre Leaders the proposal to introduce mandatory farm-level agricultural emissions reporting including the following staged approach to implementation:

3.1 starting with developing and releasing a standardised emissions calculation methodology for farm-level reporting;

3.2 then, piloting a reporting framework to refine the process and system with the sector; and

3.3 followed by mandatory reporting using the farm level reporting methodology, ahead of the commencement of any full agricultural emissions pricing system.

4 **Agree** to discuss with Food and Fibre leaders the proposal to price fertiliser emissions at the processor-level including the following components:

4.1 manufacturers and importers of synthetic nitrogen fertiliser face a levy on nitrous oxide and carbon dioxide emissions;

4.2 organic fertiliser, lime and dolomite are excluded from the levy;

4.3 for the first year, the levy prices could be based on the average NZ ETS price. For subsequent years, the Climate Change Commission could provide advice on the unique levy rates; and

4.4 revenue is used to cover levy system administration costs, and to support further emissions reductions within the agricultural sector. A revenue recycling strategy could be developed in consultation with the sector to prioritise how the revenue could be spent, including on research and development, incentive payments for emissions mitigation technologies, and any other priorities.

5 EITHER:

5.1 **Agree** to publicly consult in 2024 prior to getting Cabinet approval to draft primary legislation [Minister of Agriculture's preferred option].

OR:

5.2 **Invite** Ministers to report back to Cabinet in August 2023 for approval to draft primary legislation, with public consultation to occur as part of Select Committee processes [Minister of Climate Change's preferred option].

6 **Agree** to discuss with Food and Fibre Leaders that:

6.1 the Government has multiple related work programmes on carbon removals underway that will impact recognition of sequestration including the Carbon Removals Strategy, the NZ ETS review, voluntary carbon markets, MaxCarbon, biodiversity incentives and New Zealand's international emissions accounting changes.

1.a as part of the Carbon Removal Strategy, we propose to discuss at a high-level with the sector an Innovation Pathway. Further work is needed to explore the Pathway, including the gaps and opportunities in current government support and assessing current legal and regulatory frameworks.

7 **Agree** to publicly announce that discussions with the agriculture sector are underway on the proposals outlined in recommendations 2 – 6 following discussions with the Food and Fibre Leaders.

Authorised for lodgement

Hon Damien O'Connor

Minister of Agriculture

Hon James Shaw

Minister of Climate Change