CLASSIFICATION

Office of the Minister of Agriculture

Office of the Minister of Climate Change

Cabinet

Progress update on agricultural greenhouse gas emissions pricing

Proposal

1. This paper sets out the Government’s plans for reporting and measurement of agricultural emissions, and how the Government will recognise on-farm sequestration. It then seeks direction from Cabinet on when decisions on an agricultural pricing system should be taken and reaffirms the Government’s commitment to pricing agricultural emissions in 2025.

2. Further, this paper seeks Cabinet’s approval to publicly consult on progressing an Order in Council to defer New Zealand Emissions Trading Scheme (NZ ETS) obligations for farmers from 1 January 2024.

Relation to government priorities

3. On 2 December 2020 the Government declared a climate emergency that, “demands a sufficiently ambitious, urgent, and coordinated response across government to meet the scale and complexity of the challenge” [CBC-20-MIN-0097 refers].

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

    - the all-sectors, all-gases emissions reduction target in New Zealand’s Nationally Determined Contribution (NDC) set under the Paris Agreement
    - the domestic emission reduction targets laid out in the Climate Change Response Act 2002 (CCRA) and
    - the agricultural sub-budgets set under the domestic emissions budgets recently agreed by Cabinet [CAB-22-MIN-0152 refers].

5. Since 2008, emissions pricing has been the primary policy for reducing emissions in every sector of the economy, except agriculture. Pricing agricultural emissions is a key action in the Government’s emissions reduction plan released in May 2022.

6. Achieving the purpose of the CCRA (as amended by the "Zero Carbon Act") is a key area of cooperation between the Labour and Green Parties.

Executive summary

7. This paper seeks Cabinet's support for:

   - Mandatory reporting of on-farm emissions by Q4 2024, starting with a standardised approach to emissions measurement by April 2024,

   - Draft legislation that will enable the recognition of scientifically valid forms of on-farm sequestration within the NZ ETS or another suitable system, prior to the implementation of emissions pricing in 2025,

   - Confirmation of the Government's commitment to pricing agricultural emissions in 2025,

   - Agreement to publicly consult on progressing an Order in Council[1] to defer NZ ETS reporting obligations for farmers from 1 January 2024 to 1 January 2026.

8. This paper also seeks Cabinet's decision whether to progress final policy decisions and drafting instructions for an agricultural greenhouse gas pricing system (pricing system), based on the s215 report prior to or post the 2023 General Election.

Background

9. Agriculture contributes 49 percent of Aotearoa New Zealand's greenhouse gas emissions. The agriculture sector needs to play 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). The purpose of the Partnership was to design an agricultural emissions pricing system for agriculture, as an alternative to the NZ ETS.

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.

[1] Under section 2A (5D) of the CCRA.

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13. The system proposed a farm-level split-gas levy designed to incentivise emission reductions in line with Aotearoa New Zealand’s emissions reduction targets and maintain a viable and productive agriculture sector. It would include approximately 23,000 farmers and growers and covers approximately 96 per cent of the agriculture sector’s emissions.

14. Feedback from public consultation indicates opposition from some farmers, especially those in the arable sector, to the proposed system. Following a change of leadership and remits at their AGM in May 2023, Beef & Lamb NZ requested that more time be taken to work through concerns about the proposal. Environmental NGOs are also opposed to the proposal. The Climate Change Commission and Treasury have also expressed some concerns at the workability and efficacy of the proposals.

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

16. Officials have identified that pricing agricultural emissions by 1 January 2025 is no longer achievable and that we need more time to ensure the design of the pricing system is fit for purpose. However, the Partnership have indicated that the lack of agreement on the pricing proposal should not hold up progress on those aspects of the proposal where there is agreement, which should progress rapidly.

17. Accordingly, we propose a phased approach to agricultural emissions pricing. There is agreement with the Partnership that two areas should progress, with legislation to be passed in 2024 for:

    - A standardised approach to measuring and reporting on-farm emissions, leading to mandatory reporting of all farm-level emissions.

    - Recognition and reward for scientifically valid forms of on-farm sequestration within the NZ ETS or other appropriate system.

18. We recommend taking more time to work through the design of the pricing system itself before making final policy decisions. However, this does place the timetable of emissions pricing in 2025 at even greater risk. We seek Cabinet’s direction on this.

Farm level emissions measurement and reporting

19. Any agricultural emissions pricing system will need to be underpinned by mandatory, standardised measurement and reporting. We propose to introduce mandatory reporting to commence in Q4 2024.

20. Voluntary uptake of farm-level measurement has been good, at over 80% (against a legislated target of 100% uptake by the end of 2022). However, there are currently eleven different calculators for estimating on-farm emissions. A standardised calculation methodology would provide a consistent yardstick that could be used across the sector.

21. Therefore, as a first step, we are progressing with the development of a standardised emissions calculation methodology. This work is well underway and will be finished by April 2024. Once completed, the standardised measurement methodology will be applied to the existing eleven calculators currently in the market. We do not propose to develop a separate calculator, given the high uptake of existing calculators.

22. Requiring farmers to report their emissions will ensure they have a good understanding of their on-farm emissions and may help them identify practices and technologies that could reduce these emissions. The reporting of these emissions will provide the Government more data about on-farm emissions, including how they vary farm-to-farm.

23. Mandatory emissions reporting comes with compliance costs. As such, we propose the requirements will only apply to farms that meet the thresholds below, as outlined in the Section 215 report on agricultural emissions pricing. These are expected to cover around 96 percent of the agricultural sector's emissions.

24. We propose that reporting and monitoring requirements would apply to Inland Revenue (IR)-registered farms that:

   - have 550 stock units (inclusive of sheep, cattle and deer, calculated on a weighted annual average basis); or

   - have 50 dairy cattle; or

   - apply more than 40 tonnes of nitrogen through fertiliser annually.

25. A mandatory reporting system will also require compliance, monitoring and enforcement to ensure that farmers comply with their reporting requirements. For the system to have the best chance of success, we would need to encourage a high level of compliance.

26. Mandatory reporting will require the development of a central registry and database to manage and authenticate users and data. This is a significant IT build, requiring secure identity management and data storage. A business case will be presented in early 2024 that will provide further detail on this (pending policy decisions).

27. The proposal to implement mandatory measurement and reporting by Q4 2024 requires Cabinet decisions before the election. This is so that legislation, supporting regulations and implementation activities can be delivered in time.

28. A detailed Cabinet paper seeking final policy decisions on the reporting system will therefore be provided to Cabinet before the election, to allow issuing of drafting instructions for mandatory farm level emissions reporting.

Rewarding on-farm sequestration

29. A key focus of the agricultural sector in the design of the pricing scheme has been the recognition of carbon sequestration from on-farm vegetation that is not currently recognised in the NZ ETS. This includes indigenous vegetation, riparian margins, perennial croplands, shelter belts, scattered forest, and woodlots/tree-lots that don’t currently meet the requirements of the NZ ETS.

30. Both the sector and the Commission have expressed a preference for all scientifically valid forms of sequestration to be in the NZ ETS, rather than within parallel systems.

31. There are also other groups, such as Environmental NGOs, campaigning to include non-forest categories of sequestration in the NZ ETS, including mangroves, wetlands, peatlands, seaweed (also known as marine or ‘blue’ carbon), and the additional biomass of forests cleared of browsing pests.

32. A key barrier to recognising non-forest sequestration categories in the NZ ETS is the gap between New Zealand’s Greenhouse Gas Inventory and our target accounting.

33. Cabinet has therefore agreed in principle to include emissions and removals from non-forest land use types in New Zealand’s NDC accounting [CAB-23-SUB-0283 refers]. This will help alignment of emissions accounting between New Zealand’s international targets and NZ ETS, if/when the NZ ETS is expanded to include non-forest carbon removals and/or other incentive mechanisms.

34. Cabinet invited the Minister of Climate Change to report-back in mid-2024 with further analysis of methodologies and timeframes for expanding the NDC. Cabinet noted that more detailed advice on the accounting and fiscal implications of the change is required, and requested officials from the Ministry for the Environment, Ministry for Primary Industries, and the Treasury to report to their Ministers on this.

35. Another significant barrier is the administrative and fiscal bottleneck presented by the current system, where the burden of proof falls on the government to do the research and development required to bring additional forms of sequestration into the NZ ETS.

36. On 3 July 2023, Cabinet agreed to develop a Carbon Removals Strategy as part of the second Emissions Reduction Plan [CAB-23-MIN-0287, confirming ENV-23-MIN-0031].

37. Cabinet agreed in principle that a more flexible approach is desirable so that more non-forestry CO_2 removal activities can be recognised in the NZ ETS and other incentive mechanisms. The central proposal is to create an innovation pathway that provides a level of certainty for non-governmental actors to invest in research and development leading to the market entry of phase-out activities that are almost ready for deployment at scale.

38. Cabinet invited the Minister of Climate Change to develop legislative change options to:

- enable a broader range of non-forestry atmospheric CO_2 removal activities to be included in the NZ ETS, or in other incentive mechanisms that may be developed, following decisions on options currently under consideration for the future of forestry within the NZ ETS; and

- enable use of regulations to define NZ ETS-eligible removals activities, and to set the minimum criteria and thresholds, monitoring requirements and other matters of detail that will apply to each removals activity.

39. Cabinet also noted that the Minister of Climate Change, in consultation with relevant Ministers, will develop processes to:

- set clear criteria and expectations for the research and evidence required for market entry, to provide certainty for investors; and

- test and verify that evidence.

40. The innovation pathway under the Carbon Removals Strategy will work through the following choices needing to be addressed to bring new carbon removals activities to scale in the NZ ETS, or other incentive mechanisms:

- incentive mechanism choice and design

- standards for measurement and verification

- regulatory and legislative environment

- future funding and demand.

41. Each set of choices influence investors' assessments of risk and reward and their decisions on whether to pursue different removal activities.

On-farm sequestration timeframes

42. We propose:

- legislation to enable new removals activities to be included in the ETS or other mechanisms is in place.

- the criteria and expectations for the research and evidence required for market entry is developed, to provide certainty for investors; and

- The process and operational system to test and verify this evidence is established.

43. If Cabinet agrees to this proposal, policy decisions on any NZ ETS legislative changes would need to be made in 2024, following initial decisions from the NZ ETS review. It would be ideal for such legislation to be in place in 2025, and we intend to push hard to that effect.

44. Officials will provide a progress update to the Ministers of Agriculture and Climate Change in December 2023 on the above work, with a report-back to Cabinet by June 2024. This report-back will likely be the appropriate time to seek final decisions from Cabinet on this legislative framework and innovation pathway.

45. Having the legislative framework and innovation pathway in place at the same time as the pricing system comes into effect will provide confidence to private investors to undertake the necessary research that would allow on-farm vegetation categories to transition into the NZ ETS or other appropriate mechanisms.

46. Beyond the legislation referred to above, to enable new activities to enter the NZ ETS or other mechanisms requires:

- A package of further legislative changes and regulations to develop the framework to implement the new activities

- Private investment to ensure new categories meet the scientific requirements to be included in the system

- Development of an operational system to implement the new activities, allowing and supporting farmers to 'register land' and the regulator to provide assurance the activities are being undertaken and that the units/financial rewards allocated are representing real action.

47. Based on the introduction of the NZ ETS in 2008, the development of the forestry regulations, and the design and implementing of the 2020 Emissions Trading Reforms, officials believe the whole process to have a mature system in place could take 3-5 years. Full advice on implementation timeframes and options will be included as part of these policy decisions. Further detail on these choices and the timeframes for these is outlined in Appendix 4.

48. A short-term mechanism funded out of levy revenue could be considered to address the risk of not having effective payments for carbon sequestration occurring on-farm at the same time that farmers are required to pay for their emissions. Further detail on the potential impacts of this gap is outlined in the risk section of this paper.

49. In the event that a short-term mechanism to reward on-farm sequestration (out of levy revenue) is needed, work on expanding the ETS categories should continue. Once a relevant category of sequestration enters the ETS, there would be no need to continue on with the short-term mechanism for that category of sequestration.

Direction on pricing agricultural emissions

50. Pricing agricultural emissions remains a 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 agricultural emissions, there are choices regarding the timing to progress this.

51. We are seeking Cabinet's agreement on a preferred option to progress an agricultural emissions pricing system. Following this direction, we would return to Cabinet seeking detailed decisions to enable drafting instructions for legislative changes, if required. Appendix 1 includes a table comparing these options.

52. Both options have implementation risks. To meet a 2025 timeframe for pricing, a truncated legislative and regulatory process is necessary, which increases the risk of issues that could impact implementation. Any significant change in design from the 215 report, or any significant delay in post election decision-making, would mean that any 2025 deadline would likely not be met. Detailed regulations will also be required to support the pricing system, which may be developed in parallel to legislation.

Option 1 – Cabinet decisions pre-election on pricing by Q4 2025

53. This option seeks Cabinet decisions on a levy system (outlined below) before the election. This is to provide the greatest likelihood that legislation, supporting regulations and implementation activities, can be delivered to support a levy system by Q4 2025.

54. The levy system would build off the section 215 report and include:

- A split-gas levy that would price emissions from biogenic methane and long-lived gases (nitrous oxide and carbon dioxide) separately, set at low levels initially.

- When setting levy prices, the primary consideration would be setting a price on agricultural emissions as low as practicable while still meeting emissions reduction targets. The price would be set by Ministers next year and stay in place for an initial two years.

- Achieving emissions reductions in line with legislated targets and emissions budgets, taking into account additional factors.

- Revenue raised from the levy would be recycled back in the system, in line with a strategy that outlines spending priorities to reduce agricultural emissions and operate the system. The strategy would include operating costs and incentive payments as per the 215 report, and a dedicated fund for Māori landowners. Levy revenue may also need to be used for sequestration payments if an interim mechanism to the ETS is required.

- Incentive payments would recognise the uptake of emissions mitigation technologies.

- The Ministry for Primary Industries (MPI), Ministry for the Environment (MfE) and Inland Revenue (IR) will be responsible for implementing the system.

- The costs associated with the establishment of the levy system and the first year of mandatory reporting will be paid for by the Crown. From Q4 2025 the levy would be fiscally sustainable and meet all ongoing administration and levy offset expenses.

- If the ETS mechanism is in place by the time pricing comes into effect, the main departure from the s215 report would be that on-farm sequestration would be recognised via the NZ ETS or other mechanisms outlined in the sequestration section of this paper. If the ETS mechanism is not in place in time, sequestration would be recognised through an interim system.

55. If this option is preferred, detailed policy decisions on the levy system will also be included in a Cabinet paper before the election, alongside the decisions on mandatory reporting, to allow the issuing of drafting instructions.

56. The primary risk with this option is that it is likely to be opposed by some key members of the Partnership, and by some members of the environmental NGO sector. We note that this option was communicated to the food and fibre sector by the Prime Minister on two occasions.

Option 2 –Defer decisions on agricultural emissions pricing until after the election:

57. This option seeks Cabinet’s agreement that decisions on a pricing mechanism will be made in early 2024 at the latest. This would follow detailed design decisions on mandatory reporting and on the approach to rewarding sequestration, and further negotiations with our partners on the specifics of the pricing mechanism.

58. Officials have advised that the key risk with this option is that deferring decisions until after the election would mean it is highly unlikely that pricing could be in place by Q4 2025.

59. This means, compared to Option 1, there may be a longer period where no pricing mechanism is in place to incentivise emissions reductions from the agricultural sector. Based on the modelling conducted by Manaaki Whenua, we estimate that a delay of six months is likely to lead to foregone emissions reductions of less than 0.5MT CO_2-e for methane and 0.04 MT CO_2-e for nitrous oxide. The actual extent of foregone reductions will depend on the emissions pricing system and emissions prices Cabinet ultimately agrees to.

60. If the agricultural emissions pricing system differs from that set out in the section 215 report, it will take more time to design. If this is preferred, consultation on a pricing system could commence in mid-2024 with decisions in late 2024. Following Cabinet decisions, subsequent legislation would set out the process for transitioning to a pricing system.

61. We note Cabinet will need to consider options for how to fund a stand-alone reporting system, in the event that agricultural pricing does not begin in 2025, as we intend. Options could include reallocation within the $149.8 million tagged contingency for HWEN implementation. Given the high interest from the sector in the successful implementation of farm-level measurement and reporting, co-funding could also be an option.

62. There will also be insufficient time available to complete an accompanying regulatory impact analysis if option 2 is preferred.

63. If this option is adopted, officials will seek direction from the Minister of Climate Change and the Minister of Agriculture in December 2023 on the agricultural emissions pricing system design.

Progressing an Order in Council to defer NZ ETS obligations for animals-farmers from 1 January 2024

64. Section 65 of the CCRA includes provisions for animals-farmers[2] (farmers) to register and report in the NZ ETS from 1 January 2024 unless the date is deferred by an Order in Council[3] (OiC).

65. These provisions exist in the contingency that Cabinet had decided in favour of the backstop option of bringing agriculture into the NZ ETS, rather than an alternative system. We propose only to repeal the backstop in conjunction with legislation implementing an alternative pricing system.

66. However, there are significant risks in triggering these obligations now, including:

- it is estimated to incorporate over 100,000 participants as being included in the definition of animals-farmer in the CCRA. This definition is not aligned to the thresholds and sub-sectors for participation that was proposed in the alternative agricultural emissions pricing system. The alternative system would capture approximately 23,000 participants. The NZ ETS obligation also captures poultry, horses and pigs, on top of the other livestock sub-sectors;

- there is not a system or regulations currently in place to support farmers to meet this requirement[4];

- the EPA has no existing capability to implement NZ ETS emission reporting for over 100,000 farmers; and

- uncertainty for the agricultural sector as to their obligations and how their emissions will be priced. If the obligations under the NZ ETS are not deferred, first, they would have to register and monitor emissions for reporting purposes as prescribed in the CCRA from 1 January 2024 under the NZ ETS. When an alternative pricing system is implemented, they would then be required to report under that system.

Cabinet agreement is needed to consult and delegate functions to progress an OiC

67. Given the risks outlined above, we are seeking Cabinet's agreement to publicly consult on progressing an OiC[5] to defer NZ ETS obligations for farmers from 1

[2] CCRA definition of animal-farmer activities is "Farming, raising, growing, or keeping ruminant animals, pigs, horses or poultry for: Reward; or the purpose of trade in those animals, animal material or animal products taken or derived from those animals."
[3] Under sections 2A (5D) and 2B of the CCRA.
[4] Otherwise, ETS reporting obligations would be triggered without the supporting regulation for participants to fulfil them.
[5] Under section 2A (5D) of the CCRA.

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January 2024 to 1 January 2026. We propose consultation opens on 15 August 2023 and runs for a period of up to 3 weeks.

68. It is a statutory requirement to undertake consultation when making an OiC under section 2B of the CCRA[6]. Consultation needs to be progressed urgently before the election to ensure NZ ETS obligations do not start on 1 January 2024.

69. Appendix 3 outlines the timeframes and steps needed to progress the OiC before 1 January 2024.

70. The timeframes are tight for seeking Cabinet's approval of the OiC before 1 January 2024. To mitigate this risk, we seek Cabinet's agreement to delegate to the Prime Minister, Minister of Agriculture and Minister of Climate Change authority to make decisions in relation to deferral of the reporting requirements following consultation and authorise the Minister of Climate Change to issue drafting instructions.

71. The NZ ETS backstop will remain in place as set out in the CCRA until an alternative system is in place. When legislation for an alternative system for pricing agricultural emissions is introduced, the relevant NZ ETS obligations would be repealed.

Treaty analysis

72. The Crown has obligations to Māori through instruments of statute, case law and settlement agreements. As a partner to the Treaty of Waitangi, Government recognises the importance of the principles of partnership, participation and protection.

73. Iwi/Māori have significant interests in agribusiness and forestry, through both investment and settlement assets. It is important that Government engages meaningfully with Māori on any policy decisions regarding agricultural emissions policy that will impact Māori interests and assets.

74. Full analysis of the impacts on Māori will be provided when final policy decisions are sought.

Implementation

75. Primary legislation is required to:
   - enable the implementation of a mandatory reporting system, give power to the implementation agencies, and provide information sharing and data access between agencies,
   - include on-farm sequestration into the NZ ETS (or other similar mechanism, as appropriate), and
   - establish a farm-level pricing system, as an alternative to the ETS

76. Under all options, MPI and MfE will continue working with the sector, to first determine and publish a standardised farm-level emissions calculation

[6] Under section 2B (6) of the CCRA.

methodology, and then to implement it within sector emission calculators. This will be completed by April 2024.

77. Standards for measurement and verification of on-farm sequestration will also be required. Work on these standards will progress in 2024, alongside the Voluntary Carbon Market framework development, which is also considering appropriate measurement and verification standards for carbon sequestration activities.

78. These standards will be completed in time for having the legislative framework in place at Q4 2025, providing confidence to private investors to undertake the research that would allow on-farm vegetation categories to transition into the NZ ETS or other appropriate mechanisms.

Mandatory emissions reporting for Q4 2024

79. To support meeting timeframes for Q4 2024 mandatory emissions reporting, MPI, MfE, and Inland Revenue (IR) must progress work required to implement the system. MPI are already progressing implementation by:

- engaging with the sector to further investigate and plan a farm-level emissions reporting framework
- identifying what functionality would be necessary for MPI, IR and/or The Environmental Protection Authority (EPA) enterprise Information and Communication Technology (ICT).

80. This work will inform Business Case(s) options for Cabinet to agree the preferred detailed approach to implementing reporting and to draw down contingency funding.

Working towards the pricing system

81. Work will continue to investigate the requirements for developing and operating pricing systems.

82. Under Option 1 further work will inform Business Case(s) options for Cabinet to agree the preferred detailed approach to implementation of the proposed pricing system. For this option, the aim is to have the system implemented by Q4 2025.

83. Under Option 2, the option-specific implementation decisions on pricing will be decided later. However, decisions on implementing pricing systems that are common to any proposal will be progressed.

Cost-of-living Implications

84. In general, officials expect a low price on agricultural emissions will have no or minimal impacts on food prices. Further analysis will be provided when seeking final policy decisions on agricultural pricing.

85. Without reductions in agricultural emissions, New Zealand will need to reduce emissions elsewhere in the economy, generate more removals, or purchase more overseas emissions in order to achieve our first NDC. This may impact household costs for energy and fuel, depending on how the shortfall is met. As noted, we estimate that a six-month delay in implementing agricultural emissions pricing, based on the modelling conducted by Manaaki Whenua Landcare Research, could lead to forgone emissions reductions of less than 0.5 MT CO_2-e for methane and 0.04 MT CO_2-e for nitrous oxide.

Financial Implications

86. Agencies were provided $15.4 million funding through Budget 2023. This funding will enable MPI and MfE (and IR if option one, pricing agricultural emissions, is chosen) to continue to fund current implementation work.

87. In addition to the $15.4 million, a $149.8 million tagged contingency funding envelope was established at Budget 2023 to cover all establishment costs and the operating costs up until Q4 2025. A business case would be needed to access the tagged contingency to fund the full implementation costs, depending on the settings for the scheme. Details on the financial sustainability of the pricing policy will be provided at the point Cabinet takes final policy decisions.

Legislative Implications

88. In order to implement these decisions, three Bills will need to be prioritised as part of the 2024 Legislation Programme:

- an Agricultural Emissions Reporting Bill to implement mandatory emissions reporting
- a Carbon Removals Reform Bill after results of the NZ ETS review, to implement reforms to enable new sequestration activities in the NZ ETS (or other similar mechanism), and
- an Agricultural Emissions Pricing Bill to implement a farm-level pricing system as an alternative to the ETS.

89. When legislation for an alternative system for pricing agricultural emissions is introduced, the relevant NZ ETS obligations would also need to be repealed.

90. Regulations will be required to support primary legislation.

Risks

91. Undertaking mandatory reporting of emissions prior to pricing decisions would allow a phased approach to reporting requirements for participants while sending signals that agricultural emissions reductions are a priority. There is risk, however, in implementing a predefined reporting system at the same time that policy is being advanced on pricing mechanisms and may result in previous decisions becoming out of scope.

92. Risks related to on farm sequestration are outlined in paragraph 48.

93. It is also possible that the costs of participating in the NZ ETS outweigh the benefits from recognition of any sequestration for farmers. This will be tested as next steps on recognising sequestration are progressed.

94. Without an interim sequestration system:

- Sector support for the farm-level levy is unlikely. Recognition of on-farm sequestration at the same time as pricing is critical to mitigate the adverse impacts of pricing that disproportionately affect the red meat sector.

- The system will not adequately meet and address Treaty of Waitangi obligations and impacts on Māori. Recognition of sequestration was a critical bottom line raised by Māori during consultation.

95. Risks relating to the two options to progress agricultural emissions pricing are outlined in paragraphs 52, 56, 58, 61 and in Appendix 1.

96. Risks related to triggering obligations for animals-farmers under the NZ ETS are outlined in paragraph 67.

Impact Analysis

97. Cabinet's impact analysis requirements apply to the proposals to progress agricultural emissions pricing. However, there is no accompanying Regulatory Impact Statement, and the Treasury has not exempted the proposals from the impact analysis requirements. Therefore, the paper does not meet Cabinet's requirements for regulatory proposals.

98. The Treasury's Regulatory Impact Analysis team, the Ministry for the Environment and the Ministry for Primary Industries have agreed that supplementary analysis covering the full range of feasible options will be provided before when Cabinet next makes decisions in relation to agriculture emissions pricing.

99. With respect to consulting on deferring animals-farmer obligations in the NZ ETS, a quality assurance panel with members from the Treasury, the Ministry for Primary Industries and the Ministry for the Environment have reviewed the discussion document and determined it contains sufficient impact analysis to support Cabinet's decision to release it. Therefore a separate regulatory impact statement (RIS) is not required at this stage. A full RIS will be completed at a later stage to inform Cabinet's final decisions on this proposal.

100. The panel's view is that the discussion document partially meets the quality assurance criteria. The paper should more clearly set out objectives and criteria, and the analysis of benefits, costs and risks of the status quo versus the proposal should be strengthened and clarified. As acknowledged in the paper, one limitation is that officials have not modelled the emissions impact of delaying the backstop. The Ministry for the Environment notes that it does not have available information to provide more comprehensive impact analysis at this time.

101. The Climate Implications of Policy Assessment (CIPA) team has been consulted and confirms that the CIPA requirements do not apply to this proposal as the threshold for significance is not met.

Population Implications

102. Delaying pricing agricultural emissions delays the incentive for these emissions to be reduced. The impact of this will depend on the length of the delay. If agricultural emissions do not reduce, then further emissions reductions will be required elsewhere in the economy, more removals will be needed, or additional overseas emissions will be required, to reach our NDC1.

103. Full analysis of population implications of pricing agricultural emissions will be provided when seeking final policy decisions.

104. If the OiC is not progressed to defer animals-farmer obligations from 1 January 2024, then potentially over 100,000 animals-farmers will be required to enter the NZ ETS. This would likely carry high administration and compliance costs for farmers.

Human Rights

105. The proposals in this paper are consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.[7]

Use of External Resources

106. No use of external resources was used to support this Cabinet paper. However, some contractor and/or specialist expertise was used to support policy development of a proposed agricultural emissions pricing system to do economic modelling (including an independent peer review), a regulatory impact analysis, financial implications and implementation, and submissions analysis.

107. Further detail on the use of external resource in policy development will be provided when seeking final policy decisions.

Consultation

108. MPI and MfE publicly consulted on a proposed split-gas farm-level levy to price agricultural emissions in October 2022. A summary of submissions from this consultation is proposed to be released, pending Cabinet decisions, when final policy decisions on an agricultural emissions pricing system is sought.

109. The proposals in this paper have been tested with the Partnership in meetings with the Minister for Agriculture, the Minister of Climate Change and the Prime Minister.

110. The Department of the Prime Minister and Cabinet (PAG) was consulted on this paper.

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[7] Noting that the Ministry of Justice is responsible for scrutinising proposed legislation and advising the Attorney-General on whether it meets Bill of Rights Act requirements.

Proposed consultation process for the OiC

111. We propose consultation opens on 15 August 2023 and runs for a period of up to 3 weeks. Officials will take a traditional approach to consultation that will be comprised of a discussion document with targeted questions. It will also include:

- informing the He Waka Eke Noa Partnership prior to public consultation being announced;
- holding one webinar session for those that are not animals-farmers but who still may have an interest, for example with ENGOs;
- engagement with iwi/Māori submitters who expressed an interest in agricultural emissions pricing.

Communications

112. We will announce decisions via press release, email communications to agricultural emissions pricing stakeholders and publication on the implementation agencies' websites. A detailed communications plan will be developed jointly by our offices.

Proactive Release

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

Recommendations

The Minister of Climate Change and Minister of Agriculture recommend that Cabinet:

Farm level emissions measurement and reporting

1. **Note** that work is underway to develop a standardised farm-level emissions calculation methodology to be finalised by April 2024 at the latest.
2. **Agree** to seek final policy decisions, before the election, to enable mandatory reporting of farm level agricultural emissions from Q4 2024.
3. **Agree** the costs associated with the first year of mandatory reporting will be paid for by the Crown from within the $149.8 million tagged operating contingency.
4. **Note** Cabinet will need to consider how to fund mandatory reporting in the longer term if decisions on pricing are delayed.
5. **Note** this approach will require a Bill to be introduced in 2024 to legislate for mandatory reporting.
6. **Note** that regulations will need to be developed and in force prior to Q4 2024, for example, prescribed methodologies.

Rewarding on-farm sequestration

7. **Note** that our intention is that all scientifically valid forms of on-farm sequestration be rewarded through the NZ ETS (or alternative mechanism for rewarding carbon removals, if one is developed, following the NZ ETS review)

8. **Note** that regardless of decisions on the agricultural emissions pricing policy, work is progressing to increase recognition of non-forest carbon removals as per Cabinet's prior decision to invite the Minister of Climate Change to develop options for legislative change on this [ENV-23-MIN-0031 refers].

9. **Note** that we will return to Cabinet in 2024, following initial decisions on the NZ ETS review, seeking policy decisions on NZ ETS legislative change.

10. **Agree** to develop and implement an innovation pathway – with the aim of having this in place by 2025 – which includes:

    a. legislation to enable new removals activities to be included in the NZ ETS or other mechanisms

    b. the criteria and expectations for the research and evidence required for market entry, to provide certainty for investors; and

    c. The process and operational system to test and verify this evidence.

11. **Note** that in December 2023 officials will provide a progress update to the Minister of Agriculture and Minister of Climate Change on the development and implementation of an innovation pathway.

12. **Invite** the Minister of Agriculture and Minister of Climate Change to report-back to Cabinet by June 2024 on the development and implementation of an innovation pathway.

Agricultural emissions pricing

13. **Agree** to a preferred option for progressing decisions on an agricultural emissions pricing system:

EITHER

Option 1:

14. **Agree** to seek final policy decisions, before the election, on the establishment and implementation of a farm-level, split-gas levy system (levy system) for agricultural emissions pricing from Q4 2025.

15. **Invite** the Ministers to provide a detailed Cabinet paper before the election on a farm level system, described in the December 2022 Section 215 report, that includes the following features:

    a. Price emissions from biogenic methane and long-lived gases (nitrous oxide and carbon dioxide) separately, set at low levels initially.

    b. Levy prices set with the primary consideration being achieving emissions reductions in line with legislated targets and emissions budgets, taking

ASSIFICATION

into account additional factors such as availability and cost of on-farm mitigations and social, cultural and economic impacts on farmers, growers and communities.

c. Revenue raised from the levy would be recycled back in the system, in line with a strategy outlining spending priorities to mitigate agricultural emissions and operate the system. Levy revenue may also need to be used for sequestration payments if an interim mechanism to the ETS is required.

d. Incentive payments available to recognise the uptake of mitigation technologies that reduce emissions.

e. The Ministry for Primary Industries (MPI), Ministry for the Environment (MfE) and Inland Revenue (IR) will be responsible for implementing the system.

f. The costs associated with the establishment of the levy system and the first year of mandatory reporting will be paid for by the Crown from within the $149.8 million tagged operating contingency. From Q4 2025 the levy would be fiscally sustainable and meet all ongoing administration and levy offset expenses.

16. **Note** this approach will require policy decisions before the election and a Bill introduced in 2024 to legislate for mandatory reporting and pricing to provide the highest likelihood that a Q4 2025 date for implementing pricing can be achieved. Supporting regulations will also need to be developed and in force before Q4 2024.

OR

Option 2:

17. **Note** that the s215 report outlines an alternative farm-level pricing system to the NZ ETS backstop described in the CCRA.

18. **Agree** to implement a farm-level pricing system in 2025.

19. **Note** Cabinet decisions on pricing agricultural emissions will be deferred until late 2023 or early 2024

20. **Note** officials will seek direction from the Minister of Climate Change and the Minister of Agriculture on the agricultural emissions pricing system design in December 2023.

Progressing the Order in Council

21. **Note** that NZ ETS reporting obligations for animals-farmer activities will commence from 1 January 2024, unless deferred by an Order in Council.

22. **Agree** that the Minister of Climate Change will progress an Order in Council under sections 2A(5D) and 2B of the CCRA in August 2023 to defer animal-

farmers becoming NZ ETS participants from 1 January 2024, subject to consultation.

23. **Agree** to consult on progressing an Order in Council to defer obligations for animals-farmers under the NZ ETS under sections 2A(5D) and 2B of the Climate Change Response Act 2002.

24. **Agree** that the appended discussion document be released for public consultation in August 2023.

25. **Authorise** the Minister of Agriculture and Minister of Climate Change to make decisions on any subsequent minor amendments to the discussion document not inconsistent with the Cabinet's approvals before its release.

26. **Delegate** to the Prime Minister, the Minister of Agriculture, and the Minister of Climate Change authority to make final policy decisions on progressing this Order in Council and authorise the Minister of Climate Change to issue instructions for drafting the Order in Council following consultation.

27. **Agree** that the Minister for Climate Change must recommend to Cabinet the making of the Order in Council, before the 2023 General Election.

28. **Note** the recommending of the making of the Order in Council is subject to the outcome of consultation.

Authorised for lodgement

Hon Damien O'Connor

Minister of Agriculture

Hon James Shaw

Minister of Climate Change

Appendix 1: Comparison of options

	Progressing pricing agricultural emissions pre-election	**Defer pricing decisions till post-election**
Implementation risks	*High implementation risk* - A truncated legislative and regulatory process is necessary to enable mandatory reporting by Q4 2024. This truncated process increases the risk of issues which could impact implementation. Any delays could have significant impacts on implementation and delivery of a levy system.	*High implementation risk* - A truncated legislative and regulatory process is necessary to enable mandatory reporting by Q4 2024. This timing will also be influenced by how significantly the new pricing system differs to the one set out in the Section 215 report. Transitioning the reporting system into a different type of pricing system could potentially significantly increase implementation cost. Deferring decisions until after election would mean it is highly unlikely that pricing could be in place by Q4 2025.
Sector buy in	High level of risk of opposition from the sector	More time to get clarity around measurement and reporting and sequestration before moving to final decisions on pricing; and to build consensus on the details of pricing system
Progress towards climate change targets	Agricultural emissions will be incentivised to reduce sooner. This option could also incentivise and reward "early adopters" sooner to take up mitigation technologies, the earlier those technologies will benefit from real-world experience and can be refined and scaled to market.	For this option, there is a longer period where no policy mechanism is in place to incentivise emissions reductions from the agricultural sector. Any significant delays to incentivising reductions in agricultural emissions could require New Zealand to reduce emissions elsewhere in the economy, generate more removals (e.g. from forestry), or purchase more overseas emissions to reach our NDC1. The cost of this will depend on how the shortfall in reductions is met and its relative economic costs, compared to the cost of agricultural emissions reductions.
Impacts on farmers and growers	Pricing agricultural emissions, even at very low prices, is likely to reduce revenue and output from the drystock and dairy sectors. To mitigate this, the proposed levy system is designed to set low levy prices for a set period initially.	Impacts on farmers and growers will depend on the final design of the pricing system.
Treaty risks	A truncated policy process could affect the Crown’s ability to engage with Māori to understand the impacts of the policy	It is important that Government engages meaningfully with Māori on any policy decisions that may impact Māori, and this takes time. Progressing policy under tight timeframes or taking a new approach to pricing agricultural emissions without adequate engagement, carries Treaty risks.

Appendix 2: Order in Council Consultation Document

Appendix 3: Proposed timeframe to progress Order in Council pre-election with consultation

August 2023	Cabinet approval to consult and delegate authority to the Prime Minister, Minister of Agriculture, and Minister of Climate Change to approve policy. Authorise the Minister of Climate Change to issue drafting instructions. Consultation (3 weeks) *Assumptions to meet this timeframe: Cabinet compressed consultation period, no or minimal changes to consultation document.*
September 2023	Submissions analysis and policy development. Prime Minister, Minister of Agriculture and Minister of Climate Change decision in accordance with Cabinet's delegated authority. Issue drafting instructions. *Assumptions: 1 week for submissions analysis.* Draft OiC for Minister of Climate Change.
October 2023	Cabinet approval to submit the OiC for approval. OiC is approved and gazetted. *Assumptions: approved at Cabinet*
October	**Election 14 October**
1 January 2024	Reporting obligations for animals-farmer commence unless deferred.
1 January 2025	Surrender obligations commence (at farm level for animals' activities unless deferred).

Appendix 4: Carbon removal activities: choices and market entry timelines

a. Incentive mechanism choice and design	The carbon removals strategy will develop and apply criteria to assess which mechanisms are best suited to different CO2 removal activities. This may vary for activities with different characteristics and at different stages of development and scale. Removal activities may progress from one mechanism to another as technology and measurement develops and as they scale up.	Choices between incentive mechanisms could be made from 2024 aligning with criteria in the draft carbon removals strategy. Significant investment is likely to be required to develop the information, monitoring and governance systems needed to bring new removals into the ETS, or new mechanisms.
b. Standards for measurement and verification.	While some common standards are likely to apply to all recognised removal activities, others may vary. Investment (public and private) is likely to be required in further activity-level and national-level measurement to verify sequestration volumes for market.	Work on standards can progress in 2024, alongside Voluntary Carbon Market framework development. Obtaining necessary evidence for removal activities may require at least 3-5 years.
c. Regulatory and legislative environment	This includes both the design of incentive mechanisms (including legislation for the ETS) and the broader regulatory environment governing operation of removal activities – for example land use regulation and consenting rules.	Policy decisions on ETS legislative change in 2024, following initial decisions from ETS review. Legislation in 2024-25.
d. Implementation	Creating or updating operational systems so that farmers can apply for and enter more categories, and ensuring that they have the support and systems to do so.	Based on the introduction of the NZ ETS in 2008, the development of the forestry regulations, and the design and implementing of the 2020 Emissions Trading Reforms, we would expect this to take 3-5 years to deliver this.
e. Future funding and demand	Government signals of its future intentions to fund removals, and policy settings that affect private demand will inform investors' assessment of likely future volumes and prices for removals activities.	Dependent on outcome of ETS review. Carbon Neutral Government Programme offers options to signal demand for domestic offsetting through new removals activities.

Deferral of NZ ETS reporting obligations for animals–farmer activities

Discussion document

Appendix 5: Discussion document refused under section 18(d) as it is already publicly available

Ministry for the Environment
Manatū Mō Te Taiao

Ministry for Primary Industries
Manatū Ahu Matua

Te Kāwanatanga o Aotearoa
New Zealand Government