



Final policy decisions for action on agricultural emissions: Draft Cabinet paper

Date Submitted:		MfE tracking: 2019-B-05922 MPI tracking: B19-0463
Security Level	IN-CONFIDENCE	MfE Priority: URGENT

	Action sought:	Response by:
To: Hon James Shaw, Minister for Climate Change and Hon Damien O'Connor, Minister of Agriculture	Provide feedback to enable Ministerial consultation from Fri Aug 30 to Thu 5 Sep	Mon 26 August

Actions for Minister's Office Staff	Return the signed briefing to MfE and MPI.
Number of appendices and attachments #3	Titles of appendices and attachments: 1. Advice on allocation rate in legislation. 2. Draft Cabinet Paper - Final policy decisions for action on agricultural emissions. 3. Draft Summary of Submissions: Action on Agriculture.
Note any feedback on the quality of the report	

Ministry for the Environment and Ministry for Primary Industries contacts

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Final Policy Decisions for Action on Agricultural Emissions: Draft Cabinet paper

Key Messages

1. This briefing provides a draft Cabinet paper for you to review and provide feedback to officials on by Monday 26 August. The Cabinet paper seeks approval to legislate:

In the long term:

- a) Price livestock emissions at the farm-level by 2025
- b) Price fertiliser emissions at the processor-level by 2025
- c) Voluntary reporting on livestock emissions by 2023 and mandatory farm-level reporting on livestock emissions to start from 2024.
- d) A requirement for the Minister for Climate Change and Minister of Agriculture to jointly table a report in Parliament by 2022 on the feasibility of a farm-level scheme, and any legislative and/or regulatory changes needed. The 2022 report back will cover a range of issues including pricing instrument (e.g. levy or the Emissions Trading Scheme [NZ ETS]), and method, phasedown rate and process for free allocation.

In the interim, either:

- a) Livestock and fertiliser emissions are priced in the NZ ETS at the processor-level with 95% free allocation and recycled funds back to directly support implementation of a farm-level scheme (Option 1); *or*
- b) Enter into a formal agreement with the agriculture sector, subject to support from the sector for emissions pricing from 2025, as part of a broader farm-level policy package and a commitment to detail and cost a work programme for 2021-2025 (Option 2).

2. This Cabinet paper is to be considered by Cabinet Environment, Energy and Climate Committee (ENV) on 12 September. The timeframes for seeking Cabinet approval are:

What	By when
You provide feedback on Cabinet paper	Mon 26 August
Officials provide updated Cabinet paper to you	Fri 30 August
Consult with your ministerial colleagues	Fri 30 Aug – Thu 5 Sep
Lodge Cabinet paper	Fri 6 September (late lodgement)
ENV meeting	Thu 12 September
CAB meeting (policy decisions)	Mon 16 September
CAB meeting (legislative decisions)	Mon 14 October
Agriculture Supplementary Order Paper text to Climate Change Response Act Amendment Select Committee	Mon 14 October

Feedback from public consultation

3. Public consultation on the Government's proposals for agricultural emissions took place between 16 July and 13 August. We received nearly 4,000 submissions. The key high level themes from public consultation were:
 - The large majority of submitters support taking action to reduce agricultural emissions.
 - In general, farm-level pricing of livestock emissions in the long-term as part of a broader policy package of measures is supported across all stakeholder groups, compared to processor-level pricing. This includes support from major agricultural organisations, but only if farmers are able to account for sequestration as well as sources of emissions.
 - Interim Option 1 (processor-level emissions pricing) received majority support from environmental non-governmental organisations (NGOs), individuals, professionals, and businesses outside the agriculture sector.
 - Interim Option 2 (formal sector-government agreement) received support from significant majority of agrifood and fibre organisations, and majority support from individual farmer submissions.
 - Submissions from iwi (Waikato-Tainui, Te Arawa Climate Change Group and Ngāi Tahu) stated a preference for Option 1. In contrast, iwi/Māori primary sector groups and small and large Māori landowners and farmers (including Federation of Māori Authorities, Te Arawa Primary Sector group and Parininihi ki Waitotara) supported Option 2. All iwi/Māori submitters expressed the need for a partnership approach under the Treaty, and saw support for Māori land development as a key area for partnership (including funding for sustainable development approaches).

Advice on proposals

4. In June 2019, the Ministry for the Environment (MfE) and Ministry for Primary Industries (MPI) jointly recommended that the Government pursue a farm-level emissions pricing scheme from 2025; and as an interim measure, introduce agricultural processors into the NZ ETS [MfE 2019-B-05536 / MPI B19-0224 refers]. The New Zealand Labour Party and New Zealand First coalition agreement states that this would be done with a 95 percent allocation.
5. Officials have considered this advice again in light of feedback received through public consultation, engagement with iwi/Māori over the past four months, and having received a proposal for a formal sector-government agreement from primary sector organisations (the Primary Sector Leaders Group) [MfE 2019-B-05693 / MPI B19-0316 refers].
6. **A farm-level livestock emissions pricing scheme remains officials' preferred approach in the long-term, and feedback from consultation has confirmed wide public support for this.** A farm-level emissions pricing scheme is likely to be the most effective means of delivering on the Government's objective of a just, inclusive transition to a low-emissions economy, and achieving the 2030 and Zero Carbon Bill targets.
7. **Implementing a farm-level emissions pricing scheme by 2025 will be challenging.** In achieving this, New Zealand would likely become the first country in the world to introduce a nationwide system for farm-level measurement, reporting and pricing of agricultural emissions. Significant work is needed in partnership with the sector to determine whether a farm-level system can be technically feasible and administratively cost-effective. Determining the method for free allocation at the farm-level, regardless of the rate of free allocation, will also be challenging. These issues will be considered as part of a ministerial report to Parliament in 2022 on the detailed design of the farm-level scheme.
8. **Officials consider that either a processor-level ETS or a modified formal sector-government agreement would serve as a viable interim option towards a farm-level**

emissions pricing scheme from 2025. Which of these interim options Ministers prefer will depend on which criteria are most important to them. Each option has its own set of advantages and risks. Ministers will need to weigh these risks in considering which option to pursue.

9. **As they currently stand however, officials consider Option 1 has technically greater merit.** Option 1, a processor-level ETS, has the advantage that it introduces a policy lever now to price and therefore manage emissions over time, impacting investment decisions, and contributing towards meeting New Zealand's targets from the start of the 2020s.
10. Option 1 also provides greater funding from the sector to deliver the necessary elements of a workable and effective farm-level pricing scheme (\$40-\$50million annually from a processor-level ETS, relative to \$25 million annually plus any negotiated additional funds from the Leaders Group proposal). Examples of the uses of this funding could include the roll out of Farm Environment Plans that integrate climate change, and schemes that reward early adopters of low-emissions practises and technologies.
11. **However, Option 1 could present risk to future buy-in from agriculture stakeholders to the ultimate long-term objective of farm-level pricing from 2025.** The majority of agriculture sector stakeholders consider a farm-level policy package, including an emissions price, as optimal and have signalled a strong preference to work directly towards that goal. Their key concerns with pricing emissions at the processor-level in the interim are inefficiencies associated with recycling funds, potential policy lock in of processor pricing, and loss of goodwill across the sector that could slow progress to a farm-level policy in 2025. Compromised buy-in from the agriculture sector could make pursuing other government objectives, such as improvements in freshwater quality, more challenging.
12. Option 2 of a formal-sector government agreement has the advantage that it achieves greater buy-in from those that will be most directly affected by agriculture climate change policy – landowners, growers and farmers. However, sector leaders have not yet committed to unconditional support of emissions pricing from 2025; and their proposal does not provide a guarantee of emissions reductions in the short-term or provide as much near-term investment certainty.¹ Neither option is expected to result in sizable emissions reductions in the short-term. Officials' modelling estimates a processor-level NZ ETS would achieve a reduction in New Zealand's emissions of 0.26% prior to 2025 if introduced.
13. **Officials consider that subject to some strengthening Option 2, formal sector-government agreement could be a viable interim option.** If pursuing Option 2 officials recommend commitments are sought from sector leaders to:
 - (1) accept or support pricing agricultural emissions from 2025, whether or not it is feasible at the farm-level;
 - (2) co-governance of the programme of action with representation from iwi/Māori, government and the agriculture sector (including co-governance of funds); and
 - (3) set out and cost the 5 year programme of action together with the co-governance group by an agreed date and detail where additional sources of funding will come from if shortfall is identified. The programme of action should also reflect milestones of

¹ Both options provide marginally increased investment certainty for farmers, growers and land-owners pursuing lower emissions activities than the status quo – in particular through a) early-adopters/pilot type programmes; b) roll-out of complementary measures such as a climate change module in a farm environment plan; c) work to support farmers understand their emissions number and d) legislating farm-level pricing from 2025 this year. However, a processor-level price would also ensure processors would see a direct emissions price within their business.

voluntary emission reporting by 2023 and mandatory emission reporting by 2024 and detail specific funding for programmes to support Māori landowners.

14. If pursuing option 2 we recommend creating the ability for government to bring in a processor-level scheme by Order in Council at any time prior to 2025. This could be subject to regular review of progress assessing whether commitments and key milestones are being met.
15. **It will be critical to work with iwi/Māori under both interim options and subsequent development of a detailed work programme.** The Government needs to ensure that iwi/Māori participate as Crown partners in any negotiation with Primary Sector Leaders on an agreement. **Withheld under s9(2)(h)**
Over the medium to long term, embedding a genuine Crown/Māori partnership approach in the work programme to ensure inclusive policy development; reflect iwi/Māori aspirations for their land, assets and enterprise; and avoid potential disproportionate impacts will be critical.

Other matters

16. Officials met with you on Friday 16 August (Minister Shaw) and Wednesday 21 August (Minister O'Connor) to discuss initial advice, highlighting key issues and options for preliminary drafting on agriculture [MfE 2019-B-05778 / MPI B19-0419 refers]. Appendix 1 provides you with further advice on options for short-term legislative certainty for allocations.

Next steps

17. The current timeframe for seeking Cabinet agreement to final policy decisions is tight. To allow for changes to be made to the draft Cabinet paper in time for ministerial consultation, officials will **require feedback from your Offices on the Cabinet paper and your preferred option by Monday 26 August.**
18. We have scheduled time for ministerial consultation on the draft Cabinet paper to occur between Friday 30 August and Thursday 5 August. Officials advise that you start to engage with your colleagues on these decisions prior to the ministerial consultation period, to help ensure timeframes for decisions are met.
19. We also understand the Prime Minister is scheduled to meet with representatives of the Primary Sector Leaders Group on Wednesday 28 August. This meeting could provide an opportunity to discuss their proposal for an agreement, and potential enhancements should Ministers wish to pursue this interim option. Please advise officials if you require any further information to support you in these discussions.

Recommendations

20. We recommend that you:

- a. **Provide feedback** on the attached draft Cabinet paper to officials by close of play Monday 26 August, including on which of the interim options you wish to be reflected in the paper.
- b. **Note** farm-level livestock emissions pricing remains officials' preferred approach in the long-term, provided it proves feasible to implement.
- c. **Note** officials consider that either a processor-level NZ ETS or a modified formal sector-government agreement would serve as a viable interim option towards a farm-level emissions pricing scheme from 2025.
- d. **Note** that as currently proposed officials consider Option 1 has greater technical merit as an interim measure as it provides more certainty of a price on emissions (from 2021) and greater funding to deliver the necessary elements of a workable and effective farm-level pricing scheme.
- e. **Note** however, Option 1 could present risk to future buy-in from agriculture stakeholders to the ultimate long-term objective of farm-level pricing from 2025.
- f. **Note** Officials however consider that a formal sector-government agreement if further strengthened would serve as a viable interim option towards a farm-level emissions pricing scheme from 2025.
- g. **Note** if Ministers choose to pursue a formal sector agreement as the preferred interim measure, officials recommend clear commitments are sought from sector leaders to:
- 1) accept or support pricing agricultural emissions from 2025, whether or not it is feasible at the farm-level;
 - 2) co governance of the programme of action with representation from iwi/Māori, government and the agriculture sector (including co governance of funds); and
 - 3) cost the 5 year programme of action together with the co-governance group by an agreed date and detail where additional sources of funding will come from if shortfall is identified. The programme of action should also reflect milestones of voluntary emission reporting by 2023 and mandatory emission reporting by 2024 and detail specific funding for programmes to support Māori landowners.
- h. **Note** if Ministers choose to pursue a formal sector-government agreement Ministers will need to consider how key iwi/Māori partners are engaged as part of or alongside negotiation with Primary Sector Leaders.
- i. **Provide feedback** to officials on your preferred legislative settings for allocation rate and phase-down to be included in the draft Cabinet paper for ministerial consultation.

Yes / No

Yes / No

- j. **Agree** that this briefing and appendices will be released proactively on the Ministry for the Environment's website within eight weeks of final policy decisions.

Yes / No

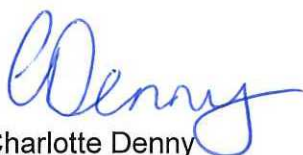
Signature



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Date

22/08/19



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Date

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Hon James Shaw
Minister for Climate Change

Date

Hon Damien O'Connor
Minister of Agriculture

Date

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Appendix 1: Advice on allocation rate in legislation

1. Officials met with you on Friday 16 August (Minister Shaw) and Wednesday 21 August (Minister O'Connor) to discuss officials' initial advice highlighting key issues and options for preliminary drafting on agriculture [MfE 2019-B-05778 / MPI B19-0419 refers]. This appendix provides you with further advice on options for short-term legislative certainty for allocations.
2. The attached draft Cabinet paper incorporates officials' initial thinking (set-out below) for how drafting can give effect to these issues.

Providing short-term legislative certainty on allocation rate

3. Officials' advice on 7 August with options for preliminary legislative drafting for allocations recommended keeping the default phase out rate and temporary suspension as currently set out in the Climate Change Response Act (the Act).
4. The Act currently allows Ministers to start phasing down agriculture allocations by 1 percentage point per annum through secondary regulations, but does not allow this phase out to start until participants begin surrendering units (paying for emissions).
5. However, submissions to consultation have raised concerns that by not having a clearly set-out path for the allocation rate, this creates a lack of certainty around cost impacts for the period until 2025 when emissions are priced at the processor-level. Stakeholders have also raised questions about the potential impact that any carbon price increase in the NZ ETS could have on near-term certainty for how a processor-level NZ ETS would affect their businesses.
6. Separate decisions taken by Cabinet this year to ensure stability of pricing in the NZ ETS will help to mitigate part of this uncertainty. However there are three additional options for how the Act could be amended to address stakeholder concerns around short-term uncertainty in relation to the level of free allocation:
 - a) Start the rate of phase down at 1 percentage point per annum immediately. [Allocations phase-down from 95% immediately]
 - b) Repeal the rate of phase down in Act. [Allocations remain at 95%]
 - c) Defer the ability to start phase down by order in Council until 1 January 2025 at the earliest. [Allocations can't be phased down until farm-level scheme starts in 2025]

In all three options, allocations for the future farm-level pricing scheme from 2025 would be considered as part of the 2022 Ministerial report.

7. Officials consider that current legislative settings on allocation rate and phase-down are suitable. However if you would like to go further in **addressing stakeholder concerns around short-term uncertainty in relation to the level of free allocation until 2025, officials recommend legislating for option C** above.
8. Option C provides further certainty of costs for the agriculture sector over the interim period until 2025, and provides the most flexibility for the Government to respond to the findings of the 2022 ministerial report. In contrast, options A and B would require primary legislation to be passed through Parliament in order to introduce any subsequent change to long-term rate of allocation from 2025 onwards.
9. To give a sense of the order of magnitude of potential cost impacts of a processor-level NZ ETS in the near-term, table 1 below sets out how average costs per unit of product could change depending on the rate of free allocation and carbon prices.

Table 1: Estimated average costs of a price on emissions for different allocation rates and carbon prices

Product (unit)	Emissions cost for different carbon prices and allocation rates					
	\$25 carbon price			\$40 carbon price		
	85% allocations	90% allocations	95% allocations	85% allocations	90% allocations	95% allocations
Milk solids (kg)	\$0.04	\$0.02	\$0.01	\$0.06	\$0.04	\$0.02
Beef (kg)	\$0.06	\$0.04	\$0.02	\$0.09	\$0.06	\$0.03
Sheep meat (kg)	\$0.08	\$0.05	\$0.03	\$0.13	\$0.09	\$0.04
Urea (tonne)	\$8.75	\$5.83	\$2.92	\$14.00	\$9.33	\$4.67

Note: Assumes no emissions reductions so is an over-estimate of actual cost. Beef cattle estimates may vary from discussion document due to assumptions around culled animals.

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Appendix 2: Draft Cabinet paper

[withheld as this draft version of the Cabinet paper was superseded by the final version, which is publicly available at www.mfe.govt.nz - search for *Final policy decisions for action on agricultural emissions*]

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Appendix 1.

Submissions Analysis

[withheld as this draft version of the submissions analysis was superseded by the final version, which is publicly available at www.mfe.govt.nz - search for *Action on agricultural emissions summary of submissions*]

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Appendix 2.

Regulatory Impact Analysis

[withheld as this draft version of the Regulatory Impact Analysis was superseded by the final version, which is publicly available at www.mfe.govt.nz - search for *Reducing greenhouse gas emissions from the agriculture sector*]

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Appendix 3.

He Waka Eke Noa: A Primary Sector Climate Change Commitment

[withheld as this is already publicly available online via DairyNZ, Horticulture New Zealand and Beef+Lamb websites]

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Appendix 3: Draft Summary of Submissions

withheld as this draft version of the submissions analysis was superseded by the final version, which is publicly available at www.mfe.govt.nz - search for *Action on agricultural emissions summary of submissions*]

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