

PROACTIVE RELEASE COVERSHEET

Minister	James Shaw	Portfolio	Climate Change
Name of package	Final policy decisions for action on agricultural emissions	Date of issue	

List of documents that have been proactively released

Date	Title	Author
6 September 2019	19-C-0480 Final policy decisions for action on agricultural emissions	Office of the Minister for Climate Change
12 September 2019	Cabinet paper appendix - A3 Option 1 v Option 2 Pros + Cons	MfE
12 September 2019	ENV-19-MIN-0047 Minute of Decision: Action on Agricultural Emissions: Final Policy Proposals	Cabinet Office
16 September 2019	CAB-19-MIN-0480 Cabinet Minute of Decision: Action on Agricultural Emissions: Final Policy Proposals	Cabinet Office

Information withheld

Some parts of this information release are not appropriate to be released and, if requested, would be withheld under the Official Information Act 1982 (the Act). Where this is the case, the relevant sections of the Act that would apply have been identified and are listed below. Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Section of the Act	Reason for withholding
s9(2)(f)(iv)	maintain the confidentiality of advice tendered by Ministers of the Crown and officials
s9(2)(g)(i)	maintain the free and frank expression of opinions by or between or to Ministers of the Crown or members of an organisation or officers and employees of any department or organisation in the course of their duty
s9(2)(h)	to maintain legal professional privilege

In Confidence

Office of the Minister for Climate Change

Chair, Cabinet Environment, Energy and Climate Committee

Final policy decisions for action on agricultural emissions

Proposals

1. This paper seeks Cabinet agreement on policy decisions to reduce greenhouse gas emissions from agriculture, including:
 - 1.1 legislative amendments to be included in the Climate Change Response (Emissions Trading Reform) Amendment Bill (the Bill); and
 - 1.2 a joint Action Plan with the agricultural sector and iwi/Māori, administered by the Ministry for the Environment and Ministry for Primary Industries.
2. This paper also appends an analysis of public submissions on the Government's policy and legislative proposals (Appendix 1); a regulatory impact assessment of available policy options (Appendix 2); and the Primary Sector Leaders Group's proposal for a formal agreement (the Commitment, provided in Appendix 3).

Executive summary

3. Intervention is required to give effect to the Government's climate change ambitions and enable the agriculture sector's contribution to the just transition to a low-emissions economy. Action is required to incentivise agricultural emissions reductions and innovation to ensure the emissions reductions are distributed efficiently and equitably across the economy and farmers are rewarded for reducing emissions.
4. I am seeking Cabinet decisions to give effect to the commitment in the Labour-New Zealand First Coalition Agreement: that in the case that agricultural emissions are priced in the New Zealand Emissions Trading Scheme (NZ ETS), they receive 95% free allocation, and the equivalent proceeds are recycled back into the sector. These decisions also relate to the commitment in the Labour-Green Confidence and Supply Agreement, which identifies primary industries as an area of particular focus for emissions reduction policy, along with a commitment to just transitions for regions and industries.
5. Over 16 July–13 August, there was a short, focused consultation on the Government's proposed response to the Interim Climate Change Committee's (Interim Committee) recommendations for action on agricultural emissions. The Parliamentary Counsel Office (PCO) is currently preparing preliminary drafting based on the legislative and policy proposals that were agreed by Cabinet for short and focused consultation [ENV-19-MIN-0039 and CAB-19-MIN-0337 refer]. I now seek agreement to final decisions for action on agricultural emissions.

6. Appendix 1 provides a full analysis of public submissions. There was general support across all stakeholder groups for farm-level pricing as compared to processor-level pricing. This included submissions from farmers, growers and major industry organisations, but only if farmers are able to account for all on-farm removals as well as sources. The majority of submissions strongly emphasised the importance of collaboration with the agricultural sector.
7. Given the level of general public support and the Interim Committee's recommendations, I consider pricing (along with financial support to farmers) to be the most efficient and cost-effective way to incentivise agricultural emissions reductions and achieve our targets. Therefore, I propose to amend the principal Climate Change Response Act 2002 (the Act) to:
- 7.1. require farm-level reporting obligations on livestock emissions in the NZ ETS, for emissions from the year beginning 1 January 2024; and
 - 7.2. price livestock emissions at the farm level and fertiliser emissions at the processor level in the NZ ETS from 2025.
8. However, given concerns around the feasibility and cost effectiveness of farm-level pricing from 2025, I recommend providing some flexibility in the Act. I propose to amend the Act to require the Minister for Climate Change and Minister of Agriculture to table a report in Parliament by 2022 which I expect will be informed by advice from the independent Climate Change Commission (the Commission) and must consider:
- 8.1. the most appropriate core design features for a farm-level pricing scheme, including if any legislative and regulatory amendments are required; and
 - 8.2. whether farm-level pricing is feasible from 2025, or if it should be deferred by Order in Council, which would enable processor-level pricing instead.
9. I recognise pricing alone is not enough. It must form part of a broader policy package to build the systems and capability required to implement the farm-level pricing scheme and achieve emissions reductions. In order to implement farm-level pricing from 2025 I propose a joint Action Plan with the sector and iwi/Māori to be administered by the Ministry for the Environment (MfE) and Ministry for Primary Industries (MPI). The Action Plan will need to recognise overlaps with the Essential Freshwater programme, including integrated farm plans, to ensure workable and effective policy on the ground. Withheld under s9(2)(f)(iv)
10. Pricing agricultural emissions is not primarily a revenue tool. It is intended to put the whole economy on a relatively level playing field, given that all other sectors have faced emissions pricing over the last decade.
11. In the interim period before 2025, there is also an opportunity to make progress to incentivise agricultural emissions reductions and support the transition to a farm-level pricing scheme. We consulted on two interim options to effect this transition, both of which have their respective advantages and disadvantages:
- 11.1. **Option 1:** pricing livestock and fertiliser emissions at processor level in the NZ ETS from 2021 (as recommended by the Interim Committee); and

- 11.2. Option 2:** a formal sector-government agreement, based on the Primary Sector Leaders Group's proposal, He Waka Eke Noa: A Primary Sector Climate Change Commitment (the Commitment), provided in Appendix 3.
12. Following consultation, I consider Option 1 preferable for its ability to provide an investment signal and regulatory line of sight, as well as aligning the approach to agriculture more closely with emissions pricing in other sectors of the economy. For these reasons, this option received majority support from environmental NGOs and think-tanks, universities, agricultural research institutes and most iwi/Māori organisations. Therefore, I also propose to amend the Act to:
- 12.1.** apply processor-level surrender obligations on livestock and fertiliser emissions, for emissions from the year beginning 1 January 2021;
 - 12.2.** amend the level of free allocation to agriculture from 90% to 95% (as per the Labour-New Zealand First Coalition Agreement); and
 - 12.3.** require free allocation to be calculated at the same time as emissions reporting occurs, thereby resulting in a net surrender obligation (i.e. 'netted off').
13. Submissions noted a processor-level price at 95% free allocation does not recognise the full suite of potential mitigation actions and may only achieve modest emissions reductions. However, processor level obligations may encourage processors to look for aggregate savings across their supply chains and suppliers, and thus balance the impacts of the transition across the agricultural sector.
14. As per the Coalition Agreement, I seek Cabinet approval to establish an Agricultural Emissions Fund (the Fund) to recycle funds equivalent to proceeds from pricing agricultural emissions to support the implementation of the Action Plan towards a workable and effective farm-level pricing scheme. I also seek Cabinet approval to appoint, alongside the Minister of Agriculture, a small, representative Governance Group responsible for overseeing the Fund and implementation of the Action Plan. The Governance Group would be supported by a technical working group comprising members with relevant expertise from the agricultural sector, iwi/Māori organisations and government agencies. This will ensure the agricultural sector, rural communities and iwi/Māori are closely involved in how we as a country choose to manage the transition to a low-emissions economy.
15. To provide the agricultural sector and rural communities with certainty and stability as they adapt to emissions pricing, I seek Cabinet's agreement to hold the level of free allocation steady at 95% for five years. Decisions about the appropriate level after 2025 would be informed by the 2022 ministerial report and specific advice on free allocation from the Commission, which will also advise the government of the day regarding free allocation rates for other sectors of the economy.
16. I have also considered a formal sector-government agreement for the interim period (Option 2). This could achieve greater buy-in from the sector. This option received significant majority support from farmers, growers and industry organisations, as well as iwi/Māori organisations with a primary sector focus. Submitters considered an agreement could leverage existing sector funding and

capability; manage a diverse range of environmental outcomes, including freshwater and biodiversity; and minimise financial and social impacts.

17. However, as it stands, the Commitment proposed by sector leaders does not provide an appropriate level of accountability or legal enforceability, and it lacks detail about how it would be implemented. If Cabinet decided to advance this option, I consider it would need:

17.1. an annual review of progress in 2020-2022 by an independent monitor (such as an auditing or consultancy firm), including a description of progress towards meeting the proposed legislative timeframes for farm level reporting and pricing, as well as recommendations to address any barriers to implementation; and

17.2. a regulation-making power to enable processor-level surrender obligations for both livestock and fertiliser emissions by Order in Council at any time prior to 2025, if the Minister for Climate Change in consultation with the Minister of Agriculture is satisfied there is insufficient progress towards meeting the legislative milestones (having regard to any report provided by the independent monitor).

18. We would also need further discussions with the Primary Sector Leaders Group to seek the sector leaders' commitment to:

18.1. reflect the same governance models that proposed for the Fund in Option 1, with representation and technical support from the sector, government and iwi/Māori;

18.2. include in the Commitment stronger support for a farm-level emissions pricing mechanism from 2025, and if not achievable, acknowledgement that the Government will price emissions at the processor level from 2025; and

18.3. cost the Commitment's Five-Year Programme of Action together with the Government by an agreed date and detail where additional sources of funding will come from if shortfall is identified.

19. This could take time, with uncertain outcomes. Given the need to provide certainty and stability, as well as the urgent need for action to reduce emissions across the whole economy, I do not recommend Option 2.

20. Withheld under s9(2)(h)
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21. I expect the Action Plan – common to both Options 1 and 2 – to embed a commitment to the unique Crown-Māori relationships to ensure inclusive policy development; reflect iwi/Māori aspirations for their land, assets and enterprise; and avoid potential disproportionate impacts. This will involve early engagement with key iwi/Māori representatives to set clear expectations and principles of

partnership in the Action Plan, facilitated through MfE's long-term Te Ao Māori Strategy.

22. There are also risks in not moving fast enough. Many iwi/Māori submissions on the Zero Carbon Bill have called for greater ambition, particularly on targets and adaptation planning.
23. A just and inclusive transition must also consider the different structures and drivers of our rural communities. Lower population densities, isolation, longer travel distances and the increased costs of goods and services pose additional challenges and potentially disproportionate impacts for these communities when responding to regulatory, market and environmental change. Future farm level policy design, therefore, needs to be informed by impacts on rural communities, including land values, profits, employment, demographics, social services and community resilience. The Government has many options to ensure a just transition, and indeed the Provincial Growth Fund is already encouraging new economic activity in the regions. The Government is already supporting the transition to high-value, sustainable land uses. We are also protecting highly productive soils from urban development and supporting regional communities to grow employment.
24. Following Cabinet agreement to these decisions, I will issue further drafting instructions to PCO, and the agriculture text will be introduced to the House no later than the end of October 2019. This will enable the Select Committee to consider, and call for public submissions on, the agriculture decisions and drafting as soon as practicable. The Select Committee may choose to adopt the drafted text itself, or it will be formally introduced as a supplementary order paper.

Background

New Zealand has committed to urgent climate change action

25. Climate change poses specific threats to agricultural production. Increasing temperatures and rainfall are expected to cause more frequent severe weather events, as well as shifting climate zones for many plant and animal species. The costs of climate change-related floods and droughts in New Zealand were estimated at a total of \$840 million over 2007-2017. These costs are expected to increase due to enhanced development in areas vulnerable to climate change.¹
26. Global greenhouse gas emissions continue to increase as a result of human activities, including livestock farming. New Zealand has committed alongside 194 other countries under the Paris Agreement to limit average global temperature increase to 2°C above pre-industrial levels and to pursue efforts to limit this increase to 1.5°C. The effort to limit warming to 1.5°C aims to avoid the worst long-term effects of climate change on people, the economy and the environment.
27. Severe weather events, including droughts and cyclones, will increase as atmospheric temperatures rise. The Government will be supporting the primary sector to reduce its emissions and adapt to climate change, recognising that it is in everyone's interest to develop a sustainable and resilient agricultural sector.

¹ Frame, D. et al. 2018. Estimating financial costs of climate change in New Zealand. Available at: <https://treasury.govt.nz/>

28. Two separate amendments have already been agreed by Cabinet to the Climate Change Response Act 2002 (the Act) to drive the domestic transition required to achieve this ambition:

28.1. The Climate Change Response (Zero Carbon) Amendment Bill (the Zero Carbon Bill) establishes an independent Commission and sets the following domestic emission reduction targets consistent with modelled global pathways² towards limiting warming to 1.5°C:

28.1.1. all greenhouse gas emissions, excluding biogenic methane, to reduce to net-zero by 2050;

28.1.2. biogenic methane emissions to reduce by 24-47% below 2017 levels by 2050; and

28.1.3. in the interim, biogenic methane emissions to reduce by 10% below 2017 levels by 2030;

28.2. The Climate Change Response (Emissions Trading Reform) Amendment Bill (the Bill) makes a targeted set of improvements to strengthen the overall operation of the NZ ETS, including forestry

29. The Paris Agreement also commits countries to set progressively ambitious nationally determined contributions (NDCs) to the global response on climate change. New Zealand's first NDC set by the previous government, also known as the '2030 Target', is to reduce net greenhouse gas emissions by 30% below 2005 levels by 2030.

The role of agriculture presents a unique challenge for domestic action

30. Meeting our targets will require a fundamental shift across all sectors of the economy and society, including agriculture. In 2017, the primary industries accounted for 11% of New Zealand's GDP. However, methane and nitrous oxide emissions from agriculture comprised almost half (48%) of total emissions.

31. The agriculture sector, including horticulture, plays a pivotal role in New Zealand's economy and society. In the year ended June 2019, agriculture and horticulture exports contributed an estimated \$39.4 billion to the economy. The dairy industry is New Zealand's largest export earner. It contributed \$18.1 billion of export revenue for the year ending June 2019 and employed 48,000 people across the country³.

32. The primary sector is also a core component of the Māori economy, whose total asset base is estimated at over \$50 billion. Māori own 50% of the fishing quota, 40% of forestry, 30% of sheep and beef production, 10% of dairy production and 0% of kiwifruit production.⁴ A large proportion of Māori land is still considered to be undeveloped, underdeveloped or underutilised.

Government intervention is required to incentivise agricultural emissions reductions in an integrated, holistic manner

² Intergovernmental Panel on Climate Change. 2019. Special Report on Global Warming of 1.5 degrees (SR15).

³ Ministry for Primary Industries. 2019. Situation and Outlook Primary Industries. Available at: <http://www.mpi.govt.nz/news-and-resources/economic-intelligence-unit/situation-and-outlook-for-primary-industries/>

⁴ Chapman Tripp. 2017. Te Ao Māori: Trends and Insights. Available at: <https://www.chapmantripp.com/>

33. We are already investing in integrated, productive and sustainable land use. Budget 19 dedicates \$229 million to protect and restore at-risk waterways and wetlands and provide support to farmers and growers to use their land more sustainably. We also know awareness and capability are particular challenges for climate change mitigation. \$122 million of this funding is set aside for:
- 33.1. providing information, tools and on-the-ground advice to support farmers and Māori agribusinesses making change to more environmentally sustainable and higher-value production;
 - 33.2. improving on-farm emissions data and upgrading decision and regulatory tools; and
 - 33.3. protecting high-value food exports and updating our official assurances system.
34. On-farm behaviour change is already happening across the country. The sector has made progress in the last decade to improve land-use outcomes, including measures to improve freshwater quality. As a result of these wider productivity and efficiency gains, the sector has also improved overall emissions intensity by an average of 1% per year. Without these measures, production growth could have resulted in a total agricultural emissions increase of almost 40% (to 2014).
35. However, more targeted and widespread action is needed. It is not enough simply to slow emissions growth or reduce emissions intensity; we must reduce the total volume of emissions. Gross agricultural emissions increased by 13.5% over 1990-2017; methane and nitrous oxide emissions increased by 7.5% and 28.8%, respectively. The main drivers of change over this period were a 650% increase in the application of synthetic nitrogen fertiliser and the dairy herd population increasing by 90%.
36. Existing trends and environmental regulations in development are expected to contribute to agricultural emissions reductions, but not enough to meet our gross biogenic methane targets. Without new policies aimed directly at reducing agricultural emissions, the costs of any gap between net emissions and our current and future NDCs could fall inefficiently and inequitably on taxpayers and other sectors of the economy.

We consulted on the Government's response to the Interim Climate Change Committee's recommendations on agriculture

37. Cabinet tasked the Interim Climate Change Committee (Interim Committee) with developing evidence, analysis and recommendations for reducing agricultural emissions [ENV-18-MIN-0042 and CAB-19-MIN-5042 refer]. The Interim Committee considered the full suite of options to deliver efficient emissions reductions consistent with a just transition, including but not limited to emissions pricing in the NZ ETS.
38. The Interim Committee delivered its recommendations report on 30 April 2019. Farm-level pricing was recommended as the best way to incentivise on-farm emissions reductions, because it puts emissions at the forefront of investment decisions and other important farm business considerations. It also gives farmers the autonomy and flexibility to determine the most efficient, cost-effective mitigation practices relative to their specific farms.

39. We agreed with the majority of the Interim Committee's recommendations, including farm-level pricing from 2025, and proposed the following legislative changes for short, focused consultation over July/August [ENV-19-MIN-0039 and CAB-19-MIN-0337 refer]:
- 39.1. pricing livestock emissions at the farm level and fertiliser emissions at the processor level from 2025;
 - 39.2. enabling voluntary farm-level reporting on livestock emissions from 2023;
 - 39.3. requiring mandatory farm-level reporting on livestock emissions from 2024;
 - 39.4. requiring responsible ministers to table a report in Parliament by 2022 on:
 - 39.4.1. the feasibility of farm-level pricing from 2025 (and whether processor-level pricing is necessary by default); and
 - 39.4.2. any legislative and regulatory amendments required.
40. Emissions pricing at the farm level is the ultimate aim, but not technically feasible or cost-effective right now, given overall sector capability and challenges for compliance and enforcement. The Government also consulted on two proposals to support the move to farm-level pricing in the interim period before 2025:
- 40.1. **Option 1:** pricing both livestock and fertiliser emissions at the processor level in the NZ ETS (the Interim Committee's recommendation);
 - 40.2. **Option 2:** the Primary Sector Leaders Group's proposal for a formal agreement with the Government, including specific commitments to reduce agricultural emissions and support the move to farm-level pricing.

Comment

I propose to amend the Act to price livestock emissions at farm level and fertiliser emissions at processor level for the period from 2025, with a review in 2022

41. The large majority of submitters supported taking action to reduce agricultural emissions. In general, farm-level pricing of livestock emissions was supported across all stakeholder groups as compared to processor-level pricing. The major agricultural organisations supported a pricing mechanism as part of a broader policy package to incentivise agricultural emissions reductions – but only if farmers are able to account for all on-farm removals as well as sources. The Minister of Agriculture and I have directed officials to report back in six months' time on how emissions pricing (or a separate policy mechanism) could account for non-forestry offsetting, including shelterbelts and other on-farm planting.
42. In general, the agricultural sector was opposed to a processor-level price on fertiliser emissions. They believed a single price-based mechanism could undermine the consideration of nitrogen fertiliser use as part of a whole farm system approach. However, horticulture and other lower-emitting agricultural industries believed the administrative costs of pricing fertiliser emissions at the farm level outweighed the benefits. Some fertiliser organisations supported a hybrid approach to enable a choice about where the point of obligation would sit.
43. Agricultural processors (including dairy factories, abattoirs and fertiliser manufacturers and importers) are already required under the Act to report on the

emissions of certain agricultural activities in each calendar year. However, currently the Act prevents processors from surrendering units in relation to those activities. I note the Act also currently defines agricultural participants and activities that may face obligations and receive free allocation at both the processor and farm level, as well as allowing for obligations on both livestock and fertiliser emissions to be swapped from processor level to farm level by Order in Council.

44. Taking into account the public submissions received, I propose to amend the Act to enable farm-level pricing of livestock emissions and processor-level pricing of fertiliser emissions in the NZ ETS from 1 January 2025. Reporting would be mandatory at the farm level for livestock emissions from 1 January 2024 (and would continue at processor level for fertiliser emissions). I consider this is likely to be the most efficient and effective means of achieving our targets and ensuring the agricultural sector's contribution to the transition to a low-emissions economy.
45. Although there was limited support for pricing fertiliser emissions at the processor level, I believe this is necessary to avoid imposing significant additional administrative costs to government and the sector without also providing additional incentives. I propose we continue to review the benefits of a farm-level or hybrid approach, if the science develops enough to demonstrate the impacts of on-farm variables (e.g. soil type, regional variation) on mitigation incentives.

Getting to farm-level pricing will take some time, and I propose legislative milestones to signal the transition

46. The Interim Committee noted establishing a farm-level pricing scheme would take some time, but could be in place by 2025. It recommended further work to develop emissions calculation tools and an appropriate method of free allocation, as well as building the administration system. These are essential features to ensure farmers have the tools and advice to be responsive to farm-level pricing.
47. Flexibility around timeframes is also critical, given the concerns around technical feasibility and cost-effectiveness of farm-level pricing. There are many detailed policy considerations yet to be worked out, which will help to determine the core legislative and regulatory design features of the farm-level pricing scheme.
48. Therefore, I also propose the Act be amended to require the Minister for Climate Change and Minister of Agriculture to table a report in Parliament no later than 31 December 2022 on the feasibility of farm-level pricing. I expect the report will be informed by advice from the independent Commission and that it must consider the most appropriate:
 - 48.1. farm-level pricing mechanism, including surrender obligations in the NZ ETS or a levy/rebate scheme;
 - 48.2. definitions of farm-level participants and agricultural activities;
 - 48.3. methodologies for calculating on-farm emissions and removals;
 - 48.4. level, method of calculation and phase-out rate of free allocation (or rebate process in an equivalent levy/rebate scheme), which must be informed by advice obtained by the Minister for Climate Change from the Climate Change Commission;

- 48.5. mechanisms to calibrate methane relative to other greenhouse gases and recognise on-farm removals (including but not limited to forestry, vegetation and plantings);
 - 48.6. organisation(s) with responsibilities for administration;
 - 48.7. data and information requirements to run the scheme, including how that data is used, shared or published by the administrator;
 - 48.8. processes, materials and tools to guide engagement with the scheme; and
 - 48.9. any required legislative and regulatory amendments for the above.
49. I do not propose to amend the Act to enable voluntary farm-level reporting in the NZ ETS from 2023, but rather to facilitate this through guidelines developed as part of the Action Plan. There would not be enough time after the 2022 report is tabled to develop the necessary supporting regulations, should farm-level pricing proceed in 2025. Nevertheless, voluntary reporting guidelines will be a critical step in the lead-up to farm-level pricing to test the development and accuracy of systems for estimating, reporting and verifying emissions.
50. I also propose to allow some flexibility around the exact start dates for mandatory farm-level reporting and surrender obligations on livestock emissions, by allowing these to be deferred by Order in Council by any period necessary and as many times as necessary. As a result, farm-level pricing of livestock emissions will apply from 2025, unless that start date is deferred by an Order in Council, in which case processor-level surrender obligations would apply instead.

A plan is needed to build capacity and prepare farmers for farm-level pricing

51. An integral part and challenge of implementing a farm-level pricing scheme will be building the capability of farmers and growers. A 2018 survey by MPI found significant gaps in farmers' understanding of their on-farm emissions: 14% of livestock farmers surveyed had estimated their livestock emissions, but only 2% in the last two years knew their on-farm emissions.
52. There are also some overlaps with this farm-level policy package and the Essential Freshwater package, soon to be announced for public consultation. The key freshwater proposals of particular relevance to agricultural greenhouse gas emissions include:
- 52.1. the requirement for all farmers to have freshwater farm plan modules that are third-party certified by 2025;
 - 52.2. new National Environmental Standards to place interim restrictions on land use intensification (applying from mid-2020); and
 - 52.3. new requirements for stock exclusion and addressing sediment discharges.
53. I propose that officials develop a plan of action (the Action Plan) together with the agricultural sector and iwi/Māori. The Action Plan, jointly administered by MfE and MPI, will build the necessary on-farm systems and capability to support farm-level pricing from 2025. Supporting measures could include:
- 53.1. a climate change module in any requirement for integrated farm plans;
 - 53.2. tools for estimating emissions at the farm level;

- 53.3. increased farm advisory capacity and capability;
 - 53.4. capacity-building tools and support for Māori landowners;
 - 53.5. incentives for early adopters; and
 - 53.6. recognition of on-farm mitigation (e.g. small plantings, vegetation).
54. The Action Plan will need to consider integration with the new freshwater requirements for farmers, growers and landowners, particularly in relation to rolling out integrated farm plans and other tools to support farmers' decision-making and avoiding the duplication of effort.

I have considered two options for getting started in the interim period before 2025, and there are trade-offs that need to be balanced

55. Although it will take some time to implement a farm-level pricing scheme, there are opportunities to get started before 2025 and make progress to incentivise agricultural emissions reductions and support the interim transition to farm-level pricing. I considered and consulted on two proposals for an interim policy measure:
- 55.1. **Option 1:** pricing livestock and fertiliser emissions in the NZ ETS at processor level (as recommended by the Interim Committee); and
 - 55.2. **Option 2:** a formal agreement with the sector with commitments to reduce agricultural emissions and support the move to farm-level pricing (based on the Primary Sector Leaders Group's proposal provided in Appendix 3).
56. Both options are different ways of getting to the same result of farm-level pricing – but each has its own advantages and disadvantages. In assessing both options, I have considered the Government's overarching objectives for climate change policy, including leadership at home and internationally; a productive, sustainable and climate-resilient economy; and a just and inclusive society.
57. The Parliamentary Counsel Office (PCO) is currently preparing preliminary drafting for both options on the basis of the legislative proposals that were agreed by Cabinet for public consultation. Either option would be supported by the Action Plan to be developed in collaboration with the sector and iwi/Māori.

In the interim, I recommend the Interim Committee's recommendation of pricing livestock and fertiliser emissions at processor level in the NZ ETS (Option 1), complemented by a commitment to free allocation stability and a mechanism for the sector to influence how proceeds are recycled

58. I consider Option 1 provides a stronger investment signal and regulatory line of sight. It introduces a policy lever to price and manage emissions immediately, helping shape investment decisions and contributing towards meeting targets from the start of the 2020s. Processor-level obligations also help encourage all processors to work with their suppliers to reduce on-farm emissions, whereas at present some may be doing this more than others. I also consider this approach to be a more efficient and equitable approach by aligning more closely with emissions pricing in other sectors of the economy.
59. Therefore, as an interim measure, I recommend pricing livestock and fertiliser emissions at processor level in the NZ ETS by amending the Act to:

- 59.1.** apply processor-level surrender obligations for both livestock and fertiliser emissions, for emissions from the year beginning 1 January 2021;
- 59.2.** amend the existing level of free allocation to agriculture from 90% percent to 95% (to give effect to the Coalition Agreement); and
- 59.3.** require free allocation to be calculated at the same time as emissions reporting occurs, resulting in a net surrender obligation.
60. Non-farmer/industry submissions expressed a firm preference for this option for the same reasons of regulatory and investment certainty, economic efficiency and fairness stated above. A slight majority of iwi/Māori submissions (both written and oral) favoured this option, emphasising the importance of a strong partnership approach and support for Māori landowners. However, it is worth noting iwi organisations with specific interests in Māori agribusiness and the primary sector stated a preference for Option 2.
61. There was some concern emissions pricing would place added financial and social pressures on the sector and rural communities, particularly as a result of land-use change and the conversion of farming to forestry. However, separately through the Zero Carbon Bill departmental report, I am proposing measures to ensure a balanced approach to afforestation. My proposed approach will help ensure we as a country strike the right balance between gross emissions reductions (e.g. from energy and transport) and net emissions (including forestry sequestration).
62. Furthermore, as per the Coalition Agreement, free allocation would be provided to agricultural processors at 95%. The Act currently calculates free allocation on the basis of production output (i.e. meat, milk and fertiliser production) and I intend to retain this in the Act. Free allocation at 95% would ensure that costs are modest and mitigate the risk of adverse effects, including potential impacts on profitability and international competitiveness, and emissions leakage.
63. To ensure certainty and stability for the agricultural sector and rural communities, I propose to keep the free allocation rate at 95% for five years. I also propose any decisions on the phase-out of free allocation to agriculture must be informed by the 2022 ministerial report and advice from the Commission (as these decisions will be in other sectors of the economy). The phase-out rate of free allocation to agriculture is currently set at 1% per year in the Act, but this is temporarily suspended until a date to be confirmed by Order in Council.
64. Therefore, I also recommend amending the Act to:
- 64.1.** specify that any phase-out of free allocation to agriculture must start no earlier than 1 January 2025;
- 64.2.** require the Commission to provide the Minister for Climate Change with advice on the phase-out of free allocation to agriculture by 1 March 2022, including recommendations on the end date for the temporary suspension and the level and phase-out rate of free allocation at farm level; and
- 64.3.** require that, if regulations are made in future affecting the level of free allocation to agriculture, the Commission must prepare advice on phase-out and provide the Minister for Climate Change with a report detailing its recommendations for those regulations.

65. It will also be important to take into account the sector's ongoing improvements in emissions intensity and avoid the risk of 'over-allocation' (wherein free allocation to agricultural participants could end up exceeding obligations). Therefore, I also propose to amend the Act to require the Minister for Climate Change to:
- 65.1.** set allocative baselines for agricultural activities through regulations;
 - 65.2.** consider and update these allocative baselines through regulations no later than five years after the date in which they are last updated; and
 - 65.3.** in setting these allocative baselines through regulations, have regard to the most recent available greenhouse gas inventory.
66. I note the above proposals would apply only to free allocation to agriculture and not to other sectors eligible for industrial allocation.
67. There are also concerns a processor-level price does not recognise or reward the full suite of actions farmers can take to reduce emissions. Economic modelling found current emissions prices coupled with 95% free allocation would achieve limited emissions reductions (around 0.26% of total agricultural emissions per year), assuming modest drops in milk and meat production and a small increase in afforestation. The model allows for on-farm efficiency measures as described in the 2018 Biological Emissions Reference Group (BERG) report⁵; however, it assumes these measures would not be taken up through a processor-level pricing scheme. Clearly we will need to do more in the medium-long term to reduce emissions.
68. As per the Coalition Agreement, the equivalent proceeds from pricing agricultural emissions in the NZ ETS could be recycled back to the sector to encourage mitigation, innovation and planting of forestry. Total funding would be equivalent to the net value of units allocated and surrendered (approximately \$40-50 million per annum at current emissions levels and carbon prices).⁶
69. I propose Cabinet agree to establish an Agricultural Emissions Fund (the Fund) as a Crown memoranda account to recycle funds equivalent to proceeds from pricing agricultural emissions in the NZ ETS to support the implementation of the Action Plan towards a workable and effective farm-level pricing scheme, including:
- 69.1.** rolling out integrated farm plans that include a climate change module;
 - 69.2.** developing a tool to estimate on-farm emissions and removals to enable farm-level emissions reporting and pricing;
 - 69.3.** advice and support for farmers and Māori landowners;
 - 69.4.** financial support for mitigation efforts;
 - 69.5.** recognition of existing high-performing farms; and
 - 69.6.** research and development (in lieu of sector's current contribution through the Pastoral Greenhouse Gas Research Consortium).

⁵ Dairy mitigation practices include farm-specific changes, such as reduced fertiliser use, change in supplement feed, reduced cow numbers with no change in milk production per cow, once-a-day milking, and planting forestry on effective milking platform. Sheep and beef mitigations (based on Reisinger et al., 2017) include reduced stocking rate while maintaining production, removal of breeding cows and planting forestry on pasture.

⁶ Total proceeds will depend on how regulations are set and the actual emissions in a given year. Note the Interim Committee initially estimated proceeds at \$47 million.

70. I also seek Cabinet approval to establish, alongside the Minister of Agriculture, a small Governance Group of government, sector and iwi/Māori representatives responsible for overseeing the Fund and implementation of the Action Plan, which will be supported by a technical working group comprising members with relevant expertise from the agricultural sector, iwi/Māori organisations and relevant government agencies. I propose that Cabinet delegate decisions regarding the design of the Fund and its Governance Group to me, the Minister of Agriculture, Minister for the Environment and the Minister of Forestry. I will report back to Cabinet to confirm the funding and governance arrangements.
71. I note regulatory amendments will be required in 2020 to support processor level obligations from 2021, including updating emissions factors and setting allocative baselines. I recommend these regulations be updated as soon as possible, and I will return to Cabinet for approval to consult with affected stakeholders on these proposed amendment regulations.

I consider the sector leaders' proposal (Option 2) lacks the necessary level of accountability and enforceability

72. There are some advantages to a formal sector-government agreement. It could achieve greater buy-in from the agricultural sector and rural communities. It could also enable the sector to manage a diverse range of environmental outcomes, including freshwater and biodiversity, and could mitigate the short-term risk of their cumulative financial impacts.
73. A significant majority of farmers, growers and industry organisations supported this option. They considered sector cooperation and capability would be essential for meeting the proposed legislative milestones and ensuring farm-level pricing and other proposals will be workable and effective on the ground. While most iwi/Māori submissions preferred Option 1, those with specific primary sector interests, including Māori agribusiness owners, supported Option 2. However, by proposing that Option 1 include the sector in decisions about how proceeds are recycled, I am taking steps to ensure strong sector cooperation and capability improvements.
74. In the Commitment, sector leaders have committed to reprioritising \$25m of annual levy funding to support climate change mitigation and adaptation, as well as raising additional funding, if required, under a co-investment approach with government. The Commitment also expressly recognises the value of tikanga and mātauranga Māori, as well as the importance of partnership with iwi/Māori to deliver on the Commitment's key actions and milestones.
75. I believe the Commitment as it stands currently lacks a significant degree of accountability and legal enforceability. Sector leaders have not yet committed to unconditional support of emissions pricing from 2025; their proposal puts a number of conditions on how a pricing mechanism would be implemented. As a result, the proposal provides less short-term assurance of agricultural emissions reductions and less investment predictability.
76. For example, in 2018, the UK Climate Change Commission reviewed the effectiveness of the UK government's land use policy in meeting climate change goals. They found that the existing policy framework, which involves an industry-led voluntary approach to emissions reduction in agriculture, is not on track to deliver the required levels of emissions reduction.

77. If Cabinet were to advance this option, we would need to bolster accountability in the Commitment, and its legal enforceability, as much as possible. This could take time, with no guaranteed outcome. I would recommend amending the Act to:
- 77.1. include an annual review of progress in 2020-2022, including a description of progress towards meeting the legislative milestones for farm-level reporting and surrender obligations, as well as recommendations to address any barriers to implementation;
 - 77.2. require the Minister for Climate Change to appoint an independent monitor (such as an auditing or consultancy firm) to complete the annual review by 30 June of 2021, 2022 and 2023 for each of the years prior; and
 - 77.3. create a regulation-making power to apply processor-level surrender obligations for agriculture by Order in Council at any time prior to 2025, if the Minister for Climate Change in consultation with the Minister of Agriculture is satisfied there is insufficient progress towards meeting the legislative milestones for farm-level reporting and pricing having regard to any report provided by the independent monitor in making this decision.
78. I would also recommend officials conduct further discussions with the Primary Sector Leaders Group to seek sector leaders' commitment to:
- 78.1. reflect the governance model proposed for the Fund in Option 1, including both representation and technical support from the sector, government and iwi/Māori; and
 - 78.2. include in the Commitment stronger support for a farm-level emissions pricing mechanism from 2025, and if not achievable, acknowledgement that the Government will price emissions at the processor level from 2025; and
79. Ensuring that there is sufficient funding to implement the Commitment's Five-Year Programme of Action is an important part of moving to a farm-level pricing scheme. I have considered options to legislate that the Commitment raise annual funds equivalent to that raised under Option 1, including introducing a new levy on agricultural activities in the Act and/or an additional regulatory 'backstop' that is triggered if the sector is unable to raise equivalent funds.
80. I have weighed the pros and cons of legislating these options. Neither one is attractive, given the challenges and delays associated with increasing agricultural levies, general uncertainty over the amount of funding required and an overall risk of losing sector buy-in. Instead, if Cabinet were to advance this option, I propose that the Government work with the sector to cost the Five-Year Programme of Action by an agreed date and detail where additional sources of funding will come from if a shortfall is identified. While this does not guarantee additional funding, the proposed co-governance model should hold the sector accountable, including on its commitment to raise additional funding, if necessary, through a co-investment approach with government.
81. I acknowledge that this approach could also increase the risks of delay. This could be mitigated by setting an agreed deadline for negotiations to be completed. If this deadline is not met, there remains the 'backstop' option of introducing processor-level obligations in the NZ ETS at any time.

82. I consider the above proposals (along with the 2022 report) would strike a better balance between encouraging sector buy-in and ownership of the climate change challenge, at the same time as providing regulatory backstops if there was insufficient progress towards meeting legislative milestones.

Consultation

83. A short, focused consultation took place for four weeks over 16 July–13 August. This included roadshows, technical workshops and hui led by officials from the MfE and MPI in a total of 18 urban and regional centres.
84. Consultation material included the public discussion document and the Interim Committee's report and technical appendices, as well as various online tools. Despite it being calving season, there was strong attendance at public meetings from farmers, growers and industry organisation representatives. A total of 3,976 written submissions were received.
85. As noted, submissions generally supported the proposal for a farm level pricing scheme as compared to processor-level pricing, provided that abatement removals were accounted for as well as sources. However, non-agricultural submitters, including individuals, NGOs, think-tanks, universities and research institutes, tended to prefer Option 1 over Option 2, compared to agricultural sector submitters.
86. Consultation also included a range of targeted material to provide information and seek feedback on iwi/Māori-specific impacts. There were two hui held in Wellington and Rotorua as requested specifically by representatives of Ngāi Tahu and Te Arawa. Iwi/Māori submissions, both written and oral, supported recognition of Te Tiriti and a strong partnership approach in the Action Plan towards farm-level pricing, but were divided over Option 1 and Option 2 in the interim. A slight majority of iwi/Māori organisations favoured Option 1, compared to a minority with specific interests in the primary sector who preferred Option 2.
87. The Environmental Protection Authority (EPA), MPI, Ministry of Business, Innovation and Employment, Ministry of Foreign Affairs and Trade (MFAT), Office for Māori Crown Relations – Te Arawhiti, Te Puni Kōkiri and the Treasury were consulted on the proposals in this paper. The Department of Prime Minister and Cabinet was informed.
88. MPI considers a farm-level livestock emissions pricing scheme is likely to be the most effective means of delivering on the Government's objectives in the long term. However, implementing a farm-level emissions pricing scheme by 2025 will be challenging, and significant work is needed in partnership with the sector to determine whether a farm-level scheme can be technically feasible and administratively cost-effective.
89. MPI considers that either Option 1 (a processor-level ETS) or Option 2 (a modified formal sector-government agreement) would serve as a viable option in the interim.
90. As the options currently stand, MPI considers Option 1 has technically greater merit, as 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. However, it could present risk to future buy-in from agriculture stakeholders to the Government's

ultimate long-term environmental and economic objectives, both on climate change and fresh water.

91. MPI believes that Option 2 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. MPI considers this should be addressed by:

- 91.1. requiring unconditional support for emissions pricing from 2025 from those involved in the Commitment's Programme of Action;
- 91.2. introducing a backstop – a regulation-making power to bring in a processor-level pricing scheme by Order in Council at any time prior to 2025, in the event that the agreement and its key milestones are not being met; and
- 91.3. setting out and costing the Commitment's Five-Year Programme of Action together with the sector by an agreed date and detail where additional sources of funding will come from if shortfall is identified.

92. Withheld under 9(2)(h)

As far as we are aware, the inclusion of agriculture in the ETS scheme is the first of its kind globally. New Zealand's international trade obligations will also need to be taken into account in the design and implementation of the Agricultural Emissions Fund.

93. The EPA has signalled throughout the policy process that without funding, the EPA will not be able to operationalise any of the climate change reform proposals, including implementing a surrender obligation for agriculture processors in the ETS. Withheld under s9(2)(f)(iv)

94. The EPA has adopted a deficit budget operating model for the 2019/20 year. This is approved by the EPA Board, and includes an operational deficit of \$0.66m. Withheld under s9(2)(f)(iv)
- The EPA has been operating at a net deficit for the last two financial years. In order to meet the 1 January 2021 effective date for climate change proposals, including detailed scoping for action on agriculture, system build and preparatory work needs to begin as soon as possible. Withheld under s9(2)(f)(iv)

Financial implications

Farm-level pricing scheme

95. The costs of implementing a farm-level scheme from 2025 will depend on the final design of the scheme. Fully assessing these costs and impacts will not be possible until more detailed analysis of different design options is carried out. Future decisions on the feasibility of farm-level pricing, including free allocation, will need to be informed by impacts on rural communities including land values, profits, employment, demographics, social services and community resilience.
96. The annual administration costs of a farm-level pricing scheme from 2025 will vary depending on the number of participants; the level of complexity of the allocation methodology; and the level of compliance.

The Action Plan

97. The proposed Action Plan will incur costs to government, including policy design, stakeholder engagement, development of estimation tools, encouraging the use of climate change modules within integrated farm plans and developing on-farm advisor systems and capability. These are all things the government could choose to do anyway, given the widespread support for working with the sector to reduce its environmental impact at the same time as supporting productivity.
98. Departmental funding allocated through Budget 19's Productive and Sustainable Land Use package may cover some part of the Action Plan. However, I expect additional resourcing will be required in relation to the completion of the 2022 report and the ongoing design of a farm-level pricing scheme.
99. Withheld under s9(2)(f)(iv)

Option 1: Processor-level obligations in the NZ ETS

100. A processor-level price in the NZ ETS, if passed on to farm suppliers, would result in increased costs faced by farmers and growers. However, these costs will be modest. The Interim Committee and officials' analysis found that a price on agricultural emissions (at current emissions prices) with 95% free allocation, is unlikely to be a key driver for rural land-use change or have major distributional impacts on rural communities and iwi/Māori.
101. Costs are estimated at 1 cent per kilogram (c/kg) of milk solids; 1c/kg of beef; 3c/kg of sheep meat; 4c/kg of venison; and \$2.92 per tonne of urea.⁷ The main driver for land-use change – especially from sheep/beef or scrub land into forestry – was considered to be the reward for carbon removal from forests, rather than agricultural emissions pricing.
102. The EPA has indicated it would require additional funding to operationalise the system changes needed for livestock and fertiliser emissions to face surrender obligations. The magnitude of these costs is too large to absorb into existing baselines, particularly where changes to the New Zealand Emissions Trading Register (operated by the EPA) are required.
103. Withheld under s9(2)(f)(iv)
- I consider these costs to be modest, given the significant importance of reducing New Zealand's total emissions. Without sufficient funding to put in place the necessary

⁷ Assuming 95% free allocation and an emissions price of \$25 per tonne of carbon dioxide equivalent (\$25t/CO₂-e).

system and operational changes, the EPA notes that it would not be able to operationalise the changes required.

104. Withheld under s9(2)(f)(iv)

104.1. Reporting: system functionality to allow for reporting, building new allocation workflows and supporting participants' reporting obligations;

104.2. Engagement: updating guidance for participants on new obligations and call centre support for existing participants;

104.3. Other internal support: resources to support delivery, including human resources support.

105. Withheld under s9(2)(f)(iv)

105.1. Compliance: desktop verification, audits, site visits and any associated enforcement actions;

105.2. Engagement: updates to guidance material for new obligations but no active engagement;

105.3. Other internal support: resources to support delivery of the proposals, e.g. human resources, legal and communications support.

106. Withheld under s9(2)(f)(iv)

Any upfront costs incurred in this financial year (2019/20) would be subject to EPA Board approval following the direction of responsible ministers.

107. As per the Coalition Agreement, I propose to recycle equivalent proceeds from agricultural emissions pricing in the NZ ETS back to the sector to encourage mitigation, innovation and planting of forestry. Total funding would be equivalent to the net value of units allocated and surrendered (approximately \$40-50 million per annum at current emissions levels and carbon prices).

108. As noted, I propose funds equivalent to NZ ETS proceeds be recycled through an Agricultural Emissions Fund (the Fund) to support the implementation of the Action Plan toward a workable and effective farm-level pricing scheme. The Minister of Agriculture and I would appoint the Governance Group to oversee the Fund, and I propose decisions regarding the overall design of the Fund and its Governance Group be delegated to us, along with the Minister for the Environment and the Minister of Forestry.

Option 2: Formal sector-government agreement

109. Primary sector leaders have committed to investing \$25 million per annum to support the five-year Programme of Action to mitigate and adapt to climate change, as well as raising additional funding, if necessary, through a co-investment approach with government. No additional costs to the sector and government are anticipated, unless additional funding is required.

110. However, as noted above, there will be some additional costs to government as part of implementing the Action Plan.

Crown/Māori Partnership

111. The first of MfE's quarterly regional hui with iwi leaders in May set an expectation for the Crown to engage with Māori on environmental and climate change policy in a more holistic and integrated manner. Iwi/Māori submissions reiterated this point, expressing a strong interest in partnership with the Crown to develop and implement the Action Plan, both to give effect to Te Tiriti and to avoid further barriers to Māori land use and development.
112. Iwi/Māori have significant interests in agribusiness and forestry, through both investment and settlement assets, and policies to address agricultural emissions could affect these investments, assets and interests in different ways. The above proposals have actively considered iwi/Māori interests in the proposals and aspirations for Māori land, assets and enterprise, through early engagement and targeted consultation. The Interim Committee and officials engaged with iwi/Māori representatives and subject matter experts to develop evidence analysis and recommendations, taking into account the unique characteristics of Māori land. Consultation involved a targeted approach, including outreach to a wide range of iwi/Māori organisations, with tailored communications material and information to seek feedback on specific iwi/Māori interests and impacts, as well as providing assistance to iwi/Māori to make oral and written submissions on the proposals.
113. Farm-level pricing was found to incur a greater risk of disproportionate impacts on Māori land use and development relative to the interim policy proposals (which are expected to apply broadly across the agricultural sector). This is due in large part to pending decisions around free allocation at the farm level, which could disadvantage parcels of Māori land that are relatively smaller, collectively owned and largely underdeveloped or underutilised. Farm-level allocation policies will need to be carefully designed through early and ongoing engagement with iwi/Māori to avoid additional barriers to Māori land use and development, including the avoidance of grandfathering and a solely output-based method.
114. I expect the Action Plan (common to both Option 1 or 2) to embed a commitment to the unique Crown-Māori relationships to ensure farm-level pricing policies are developed inclusively, reflecting iwi/Māori aspirations for their land, assets and enterprise and avoiding potential disproportionate impacts. In line with Te Arawhiti guidelines, there will be early engagement with key iwi/Māori representatives, including through the involvement of Te Arawhiti, to set clear expectations and agree the underlying principles of partnership in the Action Plan.
115. Withheld under s9(2)(h)
116. There are also risks in not moving fast enough. Many iwi/Māori submissions on the Zero Carbon Bill have called for greater ambition, particularly on targets and

adaptation planning, as well as a greater reflection of Te Tiriti o Waitangi principles and tikanga and mātauranga Māori. This feedback must be considered alongside concerns from Māori primary sector groups regarding the ambition of the 2050 biogenic methane target and the potential distributional impacts of policies on Māori land use and development.

Legislative implications

117. As agreed by Cabinet, the Parliamentary Counsel Office (PCO) is preparing preliminary legislative drafting for both Options 1 and 2, which will assist draft text on agriculture to be included shortly after the introduction of the Bill to the House of Representatives.
118. Many of the farm-level policy decisions require further complex and robust analysis, and I have recommended leaving the current settings in the Act until after the 2022 ministerial report. I note a number of regulations will be required throughout 2023/24 to enable mandatory reporting from 2024 and pricing from 2025 for livestock emissions at farm level. If the 2022 report considers significant changes are needed to the default settings, further legislative changes may be required in this period.
119. I will issue further drafting instructions to PCO, based on the decisions agreed by Cabinet in this paper, and propose the agriculture text be provided to the Select Committee considering the Bill no later than the end of October 2019. This will enable the Select Committee to consider, and call for public submissions on, the agriculture decisions and drafting as soon as practicable. The Select Committee may choose to adopt the drafted text itself, or it will be formally introduced as a supplementary order paper (SOP).
120. In order to ensure the scope of the Bill is broad enough to incorporate decisions on agriculture, I propose Cabinet agree to include the 2025-onwards proposals in the Bill at its initial introduction. In line with the decisions in this paper, the Bill as introduced would apply obligations to fertiliser emissions at processor level and livestock emissions at farm level from 2025. The later draft text (or SOP) would then include the detail and settings on the interim period (2020-2024) and any other necessary improvements. Nevertheless, we should announce the full package as soon as possible to ensure it operates as a cohesive whole.

Regulatory impact analysis

121. A Quality Assurance Panel with representatives from MfE, MPI and the Treasury Regulatory Quality Team (RQT) has reviewed the Regulatory Impact Assessment (RIA) "Reducing greenhouse gas emissions from the agriculture sector" produced by MfE and dated September 2019.
122. As a part of its assessment, the Panel also considered the Interim Committee's report, Landcare Research's modelling report prepared for MPI, a supplementary cost-benefit analysis done by MfE and a selection of stakeholder submissions.
123. The Panel considers that the RIA meets Cabinet's Quality Assurance criteria.
124. The Panel notes that while the nature of the policy area means that the analysis can be complex, the analysis is sound.

125. The Panel considers the summary section of the RIA should have included more discussion of the potential net benefits of options for a farm-level scheme. Analysis of this is covered in the Interim Committee's report and Landcare Research's modelling, and in the RIA's multi-criteria analysis, but a clear upfront summary would have aided clarity and improved confidence in the potential of a farm-level scheme. The potential viability of a farm-level scheme is an important element in deciding whether to have an interim scheme.
126. Notwithstanding the consultation the Interim Committee had already undertaken, the Panel notes that the four weeks' consultation period was unusually short. While comprehensive submissions were provided by a wide range of organised interest groups, the short period would have inhibited submissions from some individuals. It will be important for officials to consult further during implementation of the interim approach, whether this is the processor-level scheme or the industry agreement. Consultation will also be key to understanding the impacts of the farm-level scheme.
127. RQT considers that the information and analysis summarised in the RIA meets the quality assurance criteria.

Human rights

128. There are no inconsistencies between the proposals in this paper and the Human Rights Act 1993.

Gender implications

129. There are no significant [gender implications](#) in this paper.

Disability implications

130. There are no significant [disability implications](#) in this paper.

Publicity

131. I propose to announce the decisions in this paper, once agreed by Cabinet, for consideration during the Select Committee stage as soon as possible.

Proactive Release

132. I intend to release this paper proactively once agreed by Cabinet, subject to redactions as appropriate under the Official Information Act 1982.

Recommendations

The Minister for Climate Change recommends that the Committee:

Background

1. **Note** the Interim Climate Change Committee (Interim Committee) made several key recommendations for action on agricultural emissions;
2. **Note** short, focused consultation on the Government's proposed response to the Interim Committee's recommendations occurred over 16 July–13 August, which prompted a total of 3,976 submissions;

3. **Note** the Parliamentary Counsel Office (PCO) is preparing preliminary drafting on the basis of legislative proposals that were agreed by Cabinet for short and focused consultation [ENV-19-MIN-0039 and CAB-19-MIN-0337 refer];

A farm-level emissions pricing scheme

4. **Note** there was general support across all stakeholder groups for a farm-level price on emissions as part of a broader policy package to incentivise agricultural emissions reductions, provided that all on-farm emissions removals could be counted as well as sources;
5. **Note** the Act currently defines agricultural participants and activities that may face obligations and receive free allocation at both the processor and farm level;
6. **Note** that agricultural processors (including dairy factories, abattoirs and fertiliser manufacturers and importers) are already required under the Climate Change Response Act 2002 (the Act) to report emissions from certain agricultural activities in a calendar year, but the Act currently prohibits obligations in the NZ ETS in relation to these activities;
7. **Note** the Act allows for obligations on both livestock and fertiliser emissions to be swapped from processor level to farm level by Order in Council;
8. **Note** the policy intent to price livestock emissions at the farm level and fertiliser emissions at the processor level from 2025, with flexibility to review the eventual farm-level pricing mechanism and design, as well as the requirement that both livestock and fertiliser emissions are priced at the processor level in the New Zealand Emissions Trading Scheme (NZ ETS) if farm-level pricing is not deemed feasible or cost-effective by 2025;
9. **Note** that flexibility around timeframes in legislation is required, given the core farm-level policy design features are yet to be determined and there are some concerns around the feasibility and cost-effectiveness of implementing farm-level pricing;
10. **Agree** to amend the Climate Change Response Act 2002 (the Act) to:
- 10.1. apply farm-level surrender obligations on livestock emissions and processor-level obligations on fertiliser emissions, for emissions from the year beginning 1 January 2025;
 - 10.2. require mandatory farm-level reporting obligations on livestock emissions in the NZ ETS, for emissions from the year beginning 1 January 2024;
 - 10.3. amend the level of free allocation to agriculture in the Act from 90% to 95%, as per the Labour-New Zealand First Coalition Agreement;
 - 10.4. require free allocation to be calculated at the same time as emissions reporting occurs, with the resulting allocation net off against the relevant surrender obligation, thereby resulting in a net surrender obligation; and
 - 10.5. enable the proposed timeframes in recommendations 10.1 and 10.2 to be deferred by Order in Council by any period and as many times as necessary, in which case processor-level surrender obligations would apply from 2025 under the same settings (including 10.3 and 10.4 above);

11. **Note** there may not be enough time to establish regulations to support voluntary farm-level reporting from 2023 (in the lead-up to farm-level pricing of livestock emissions from 2025), but this could be facilitated by establishing guidelines;
12. **Agree** to amend the Act to require the Minister for Climate Change and the Minister of Agriculture to table a report in Parliament by 31 December 2022 on the farm-level pricing scheme for both livestock and fertiliser emissions, which must consider the most appropriate:
- 12.1. farm-level pricing mechanism, including surrender obligations in the NZ ETS or a different levy/rebate scheme;
 - 12.2. definitions of farm-level participants and agricultural activities (who should be a participant and which activities should be covered);
 - 12.3. methodologies for calculating emissions and removals;
 - 12.4. level, method of calculation and phase-out rate of free allocation (or rebate process in an equivalent levy/rebate scheme), which must be informed by advice obtained by the Minister for Climate Change from the independent Climate Change Commission (the Commission);
 - 12.5. mechanisms for calibrating methane relative to other greenhouse gases and recognising removals, including but not limited to on-farm forestry, vegetation and plantings;
 - 12.6. data and information requirements to run the scheme, including how that data is used, shared or published by the administrator;
 - 12.7. processes, materials and tools to guide engagement with the scheme;
 - 12.8. organisation(s) with responsibilities for administration; and
 - 12.9. any legislative and regulatory amendments, if required;
13. **Note** the Act currently provides for a phase-out of free allocation to agriculture at 1% per year after the first year of surrender obligations, but this is currently temporarily suspended until a date to be confirmed by Order in Council;
14. **Note** as part of the changes proposed through the Climate Change Response (Emissions Trading Reform) Amendment Bill (the Bill), the Commission will advise on the phase-out of industrial allocation to other sectors;
15. **Note** there is a specific risk of over-allocation to the agricultural sector if allocative baselines for agricultural activities are not periodically updated to account for the sector's ongoing improvements in emissions intensity;
16. Withheld under s9(2)(h) [REDACTED];
17. **Agree** to amend the Act to:
- 17.1. specify that any phase-out of free allocation to agriculture must start no earlier than 1 January 2025;
 - 17.2. require the Commission, by 1 March 2022, to provide the Minister for Climate Change and the Minister of Agriculture with advice on the phase-out of free allocation to agriculture;

- 17.3. require that, before regulations are made in future affecting the level of free allocation to agriculture:
- 17.3.1. the Commission must prepare advice on phase-out and provide the Minister for Climate Change and the Minister of Agriculture with a report detailing its recommendations for those regulations; and
 - 17.3.2. the Minister must consider the recommendations of the Commission prior to making regulations affecting the level of free allocation to agriculture;
- 17.4. require the Minister for Climate Change to:
- 17.4.1. set allocative baselines for agricultural activities through regulations;
 - 17.4.2. consider and update those allocative baselines through regulations no later than five years after the date in which they are first updated; and
 - 17.4.3. in setting those allocative baselines through regulations, have regard to the most recent available greenhouse gas inventory;
- 18. Note** the above proposals apply only to agricultural activities and are not intended to apply to other activities or participants eligible for industrial allocation;
- 19. Note** agricultural processors have been reporting livestock and fertiliser emissions in the NZ ETS since 2012, allowing adequate time for those participants to become familiar with NZ ETS reporting requirements;
- 20. Agree** to amend the Act:
- 20.1. so that agricultural processors (for both livestock and fertiliser emissions) would be subject to NZ ETS penalties regimes from their first year of surrender obligations in the NZ ETS;
 - 20.2. to retain the transitional provisions for penalties to farmers (for both livestock and fertiliser emissions), meaning they are not subject to these penalties in their first year of surrender obligations in the NZ ETS but would be subject to penalties from the second year of surrender obligations;

A joint and integrated Action Plan towards farm-level pricing

- 21. Note** an integral part and challenge of implementing a farm-level pricing scheme will be building the capability of farmers, growers and other land users;
- 22. Note** that Budget 19 allocated \$229 million to a Productive and Sustainable Land Use Package, which specifically included \$122 million to:
- 22.1. provide information, tools and on-the-ground advice to support farmers and Māori agribusinesses making change to more environmentally sustainable and higher-value production;
 - 22.2. improve on-farm emissions data and upgrade decision and regulatory tools; and
 - 22.3. protect high-value food exports and update our official assurances system;
- 23. Note** the overlaps between the proposals in this paper and the Essential Freshwater package and the need for an integrated on-farm approach;

- 24. Agree** that officials will develop a joint Action Plan with the agricultural sector and iwi/Māori, which will be administered by the Ministry for the Environment and Ministry for Primary Industries, to build the necessary on-farm systems and capability to support farm-level pricing from 2025, including:
- 24.1. a climate change module in any requirement for integrated farm plans;
 - 24.2. tools for estimating emissions at the farm level;
 - 24.3. increased farm advisory capacity and capability;
 - 24.4. incentives for early adopters; and
 - 24.5. recognition of on-farm mitigation (e.g. small plantings, vegetation);
- 25. Note** the Minister for Climate Change and the Minister of Agriculture have directed officials to report back in six months' time on how emissions pricing in the NZ ETS (or a separate policy mechanism) could account for non-forestry offsetting, including shelterbelts and other on-farm planting;
- 26. Note** the Action Plan will seek to embed a commitment to the unique Crown-Māori relationships and will include early engagement with key iwi/Māori representatives, involving the Office for Māori Crown Relations (Te Arawhiti), to set clear expectations and agree the principles of partnership in the Action Plan;
- 27. Withheld under s9(2)(f)(iv)**

Interim action on agricultural emissions

- 28. Note** the short, focused consultation over July-August included the following two options proposed by the Government for an interim policy measure to encourage agricultural emissions reductions in line with New Zealand's climate change targets and to support the transition to farm-level pricing from 2025;

EITHER Option 1: Processor-level pricing in the NZ ETS (preferred by the Minister for Climate Change)

- 29. Agree** to amend the Act to apply processor-level surrender obligations for both livestock and fertiliser emissions, for emissions from the year beginning 1 January 2021, with 95% free allocation netted off against surrender obligations;
- 30. Note** the Labour New Zealand First Coalition Agreement states that, if agricultural emissions are priced in the NZ ETS, all proceeds will be recycled back to the sector to encourage mitigation, innovation and additional planting of forestry;
- 31. Agree** to establish an Agricultural Emissions Fund (the Fund) as a Crown moratoria account to recycle funds equivalent to the value of units surrendered annually in the NZ ETS to support the implementation of the Action Plan towards a workable and effective farm-level pricing scheme, including:
- 31.1. rolling out integrated farm plans that include a climate change module;
 - 31.2. developing a tool to estimate on-farm emissions and removals to enable farm-level emissions reporting and pricing;
 - 31.3. advice and support for farmers and Māori landowners;
 - 31.4. financial support for mitigation efforts;

- 31.5. incentives for existing high-performing farms; and
- 31.6. research and development (in lieu of sector's current contribution through the Pastoral Greenhouse Gas Research Consortium);
- 32. Authorise** the Minister for Climate Change and Minister of Agriculture to appoint a small Governance Group of government, sector and iwi/Māori representatives to oversee the Fund and implementation of the Action Plan, which will be supported by a technical working group comprising members with relevant expertise from the agricultural sector, iwi/Māori organisations and government agencies;
- 33. Agree** to delegate decisions regarding the design of the Fund and its Governance Group to the Minister for Climate Change, Minister of Agriculture, Minister for the Environment and Minister of Forestry;
- 34. Note** the Minister for Climate Change will report back to Cabinet to confirm the funding and governance arrangements for the Fund;
- 35. Note** that New Zealand's international trade obligations will need to be taken into account in the design and implementation of the Fund;
- OR Option 2: A formal sector-government agreement (not preferred)**
- 36. Agree** to develop a formal sector-government agreement based on the Primary Sector Leaders Group's proposal, He Waka Eke Noa: A Primary Sector Climate Change Commitment (the Commitment) provided in Appendix 3;
- 37. Note** the Commitment as it stands lacks accountability and legal enforceability mechanisms, as well as a satisfactory degree of commitment to agricultural emissions reductions and farm-level pricing from 2025;
- 38. Agree** to bolster accountability and enforceability in the Commitment by amending the Act to:
- 38.1. include an annual review of progress in 2020-2022, including a description of progress towards meeting the legislative milestones for farm-level reporting and obligations, as well as recommendations to address any barriers to implementation;
- 38.2. require the Minister for Climate Change to appoint an independent monitor (such as an auditing or consultancy firm) to complete the annual reviews by 30 June of 2021, 2022 and 2023 for each of the years prior; and
- 38.3. create a regulation-making power to apply processor-level surrender obligations for agriculture to commence by Order in Council at any time prior to 2025, if the Minister for Climate Change in consultation with the Minister of Agriculture is satisfied there is insufficient progress towards meeting these legislative milestones, having regard to any report provided by the independent monitor in making this decision;
- 39. Agree** to further discussions with the Primary Sector Leaders Group to seek the sector leaders' commitment to:
- 39.1. reflect the governance model in Option 1, including a small Governance Group of government, sector and iwi/Māori representatives to oversee the funding and implementation of the Commitment's Five-Year Programme of Action, which will be supported by a technical working group comprising

members with relevant expertise from the agricultural sector, iwi/Māori organisations and government agencies;

39.2. include in the Commitment stronger support for a farm-level emissions pricing mechanism from 2025, and if not achievable, acknowledgement that the Government will price emissions at the processor level from 2025; and

39.3. cost the Commitment's Five-Year Programme of Action together with the Government by an agreed date and detail where additional sources of funding will come from if shortfall is identified;

Financial implications

40. Note the economic impacts and fiscal implications of farm-level pricing will depend on the final design of the scheme and are, therefore, yet to be determined;

41. Note economic modelling suggests current emissions prices with 95% free allocation would likely result in modest additional costs to milk, meat and fertiliser production;

42. Note additional funding is likely to be required to resource implementation of the Action Plan (which will be necessary for the completion of the 2022 report and the development of a workable and effective farm-level pricing scheme)

Withheld
under s9(2)
(f)(iv)

43. Note the Environmental Protection Authority has indicated additional funding would be required to operationalise the first year implementation of processor-level surrender obligations for agriculture from 1 January 2022

Withheld under
s9(2)(f)(iv)

44. Withheld under s9(2)(f)(iv)

45. Note any upfront costs incurred in this financial year (2019/20) would be subject to EPA Board approval following the direction of responsible ministers;

Crown/Māori Relationships

46. Withheld under s9(2)(h)

47. Withheld under s9(2)(h)

48. Note there will be early engagement with key iwi/Māori representatives, including with the involvement of Te Arawhiti, to set clear expectations and agree the principles of partnership in the Action Plan;

Legislative implications

49. Invite the Minister of Climate Change to issue drafting instructions to the PCO based on the agreed decisions above;

50. **Note** a number of regulatory amendments are likely to be required throughout 2023/24 to enable mandatory farm-level reporting from 2024 and farm-level pricing from 2025 for livestock emissions;
51. **Authorise** the Minister for Climate Change, in consultation with the Minister of Agriculture as appropriate, to further clarify and develop policy matters relating to the amendments proposed in this paper, in a way not inconsistent with Cabinet's decisions;
52. **Note** the decisions in this paper will be introduced in two stages in order to ensure the scope of the Bill is broad enough to permit inclusion of the proposed amendments for agriculture either through Select Committee or a supplementary order paper (SOP):
- 52.1. at introduction on 23 September, the Bill will include farm-level obligations on livestock emissions and processor-level obligations on fertiliser emissions at 2025; and
- 52.2. during Select Committee, the draft text will include Cabinet decisions on the interim option, as well as any other consequential improvements;
53. **Agree** legislative drafting will be introduced to the House of Representatives for inclusion in the Bill no later than 31 October 2019
54. **Agree** that, to facilitate timely implementation of Cabinet's decisions, the Minister for Climate Change may share this Cabinet paper, drafts of further Cabinet papers on related issues, drafting instructions to the PCO, subsequent drafts of amendments and related documents with the Environmental Protection Authority as a key agency in the proposed amendments;
55. **Note** amendments to secondary regulations will also be required in 2020, including updating emissions factors and setting allocative baselines, to support processor-level obligations from 1 January 2021;
56. **Note** the Minister for Climate Change will return to Cabinet in 2020 to agree the proposed amendment regulations for consultation with affected stakeholders;
57. **Invite** the Minister for Climate Change to return to Cabinet in 2020 for approval to consult on the updated emissions factor regulations in 2020;

Regulatory Impact Statement

58. **Note** the Treasury's Regulatory Quality Team considers the attached regulatory impact assessment (Appendix 2) meets the quality assurance criteria;

Publicity and proactive release

59. **Agree** to announce all decisions in this paper as a whole cohesive package, once agreed by Cabinet, for consideration during the Select Committee stage as soon as possible;
60. **Note** the Minister for Climate Change intends to release this paper proactively, subject to redactions as appropriate under the Official Information Act 1982.

Authorised for lodgement.

Hon. James Shaw

Minister for Climate Change

Proactively released

Appendix 1.

Submissions Analysis

Draft version of Submissions Analysis withheld as final version is to be publicly released at the same time as this cabinet paper.

Proactively released

Appendix 2.

Regulatory Impact Analysis

Released proactively at the same time as this cabinet paper.

Proactively released

Appendix 3.

He Waka Eke Noa: A Primary Sector Climate Change Commitment

Withheld as document is already available publicly

Proactively released

GETTING TO FARM-LEVEL PRICING (2021-2025): OPTION 1 vs OPTION 2

PROPOSALS

PROS

CONS

OPTION 1: PROCESSOR-LEVEL PRICING IN NZ ETS

- Price on emissions from 2021.
- 95% free allocation (possibly fixed for five years).
- Annual proceeds (~\$41m)* recycled back to implement Action Plan.
- Action Plan and funds co-governed with sector & Māori
- Recommended by the Interim Climate Change Committee.

- Minor but positive emissions reductions before 2025 (0.26% pa).
- Positive perception from other sectors and society that the ag sector is contributing to the transition
- Regulatory and investment certainty in the lead-up to farm-level pricing.
- Incentive for processors to work with farm suppliers to reduce emissions immediately, towards the Zero Carbon Bill goal of 10% by 2030.
- Funds recycled to implement Action Plan to develop workable and effective farm-level scheme
- Co-governance of recycled funds could assist with sector buy-in and discretion over funding decisions
- Near term certainty.

- Does not incentivise full range of on-farm mitigation practices.
- Modelling shows only minor emissions reductions (around 0.26% pa of total agricultural emissions)*.
- Risks weakening sector buy-in and long-term commitment to on-farm behaviour change.
- Small pass-through costs to farmers: 1c/kg beef, 3c/kg sheep, 1c/kg milk solids*.
- Small cost to the Crown to upgrade EPA systems
- Withheld under s9(2)(g)(i)

OPTION 2: FORMAL SECTOR-GOVT AGREEMENT

- 5-year programme of action (2020-2025).
- Legislated annual review and backstop to bring in processor-level pricing at any time**.
- Commits to \$25m existing annual levy funds, as well as raising additional funds under co-investment with govt.
- Co-governance model with iwi/Māori and sector.

- Reflects sector consensus to reduce on-farm emissions, including the role of a farm-level pricing mechanism after 2025.
- Withheld under s9(2)(g)(i)
- No immediate costs to Crown, but costs unknown as programme of action yet to be costed – small cost associated with annual reviews of progress.

- No incentive for emissions reductions in the short term.
- Does not provide as much near-term investment certainty.
- Risk that incentive is on sector to delay and work to avoid a price in 2025 rather than toward it.
- Withheld under s9(2)(g)(i)
- An improved agreement It will take time to agree and implement.

Proposed improvements:

- Seek ongoing commitment from sector leaders to pricing agricultural emissions from 2025 as part of broader package.
- Commitment to cost 5-year programme of action and detail how shortfalls could be covered.
- Legislate for annual reviews of progress by auditor.
- Legislate option to bring in processor-level pricing in NZ ETS if sufficient progress is not made.