TE TAI ŌHANGA
THE TREASURY

Reference: 20220396

11 November 2022

[redacted]

Dear [redacted]

Thank you for your Official Information Act (OIA) request, received on 20 September 2022. You requested the following information:

> *all written advice, including reports, advice, aide memoirs, briefing notes and analysis / including emails), from the Treasury to Ministers and Ministers Offices related to the He Waka Eke Noa Primary Sector Climate Action Partnership. I also request any written communications between the Treasury and other government departments relating to the He Waka Eke Noa Primary Sector Climate Action Partnership. Where emails have been shared please include attachments to emails.*

Following an extension to the due date of 30 working days, we engaged with you and refined the scope into two tranches, treated as separate OIAs: (1) **formal advice to Ministers** (TRs, AMs, etc) relating to He Waka Eke Noa, (2) **comments to other ministries on draft Cabinet papers** relating to He Waka Eke Noa.

Information being released

Please find enclosed the following documents related to tranche one of the request.

Tranche two of our request will be provided to you on or before 1 December 2022.

Item	Date	Document Description	Decision
1.	9 June 2022	Aide Memoire: Agricultural Emissions Pricing: Initial Treasury Advice T2022/1288	Release in part
2.	17 June 2022	Treasury Report: Briefing for 20 June Meeting of the Climate Response Ministers Group T2022/1304	Release in part
3.	21 July 2022	Treasury Report: Agricultural Emissions Pricing: Treasury Advice on Policy Options T2022/1303	Release in part
4.	11 August 2022	Treasury Report: Briefing for 16 August Meeting of the Climate Response Ministers Group	Release in part
5.	15 August 2022	Email: RE: Supplementary advice on agricultural emissions pricing to support August 16 CRMG	Release in part
6.	14 September 2022	Treasury Report: Agricultural Emissions Pricing: Treasury Advice ahead of Ministerial Consultation T2022/1789	Release in part

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7.	21 September 2022	Aide Memoire: Supplementary advice on agricultural emissions pricing to support ministerial consultation T2022/2098	Release in part

I have decided to release the relevant parts of the documents listed above, subject to information being withheld under one or more of the following sections of the OIA, as applicable:

- names and contact details of officials, under section 9(2)(g)(ii) – to maintain the effective conduct of public affairs through protecting Ministers, members of government organisations, officers and employees from improper pressure or harassment,
- advice still under consideration, section 9(2)(f)(iv) – to maintain the current constitutional conventions protecting the confidentiality of advice tendered by Ministers and officials,
- certain sensitive advice, under section 9(2)(g)(i) – to maintain the effective conduct of public affairs through the free and frank expression of opinions, and
- direct dial phone numbers of officials, under section 9(2)(k) – to prevent the disclosure of information for improper gain or improper advantage.

We have redacted the direct dial phone numbers of officials under section 9(2)(k) in order to reduce the possibility of staff being exposed to phishing and other scams. This is because information released under the OIA may end up in the public domain, for example, on websites including Treasury's own website.

Please note that this advice was part of an iterative policy development process. Many of the concerns we raised as part of earlier advice were subsequently addressed by lead agencies through the policy development process. Additionally, aspects of policy proposals or modelling referred to in our advice were preliminary or work in progress at that point in time. Our advice should be read with this context in mind.

In making my decision, I have considered the public interest considerations in section 9(1) of the OIA.

Please note that this letter (with your personal details removed) and enclosed documents may be published on the Treasury website.

This reply addresses the information you requested. You have the right to ask the Ombudsman to investigate and review my decision.

Yours sincerely

James Haughton
Manager, Natural Resources

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TE TAI ŌHANGA
THE TREASURY

Reference: T2022/1288 AC-4-5-21

Date: 9 June 2022

To: Minister of Finance (Hon Grant Robertson)

Deadline: None

Agricultural Emissions Pricing: Initial Treasury Advice

1. On 31 May, the *He Waka Eke Noa Partnership* ('the Partnership') presented the Ministers of Agriculture and Climate Change their final report on agricultural emissions pricing. Minister O'Connor took an oral item to DEV on 1 June [DEV-22-MIN-0118 refers] and we understand it was an agenda item at Cabinet on 7 June. This aide memoire outlines the decisions that you will face over the coming months, indicative insights on areas of particular focus and risk, and our plan for subsequent advice.

Pricing agricultural emissions by 2025

2. Pricing agricultural emissions is an integral component of the comprehensive policy response required to achieve New Zealand's climate objectives. Agricultural emissions are legislated to be priced by 1 January 2025.

3. Cabinet is due to make initial policy decisions on the Government's preferred pricing option in August. This will be followed by public consultation before final policy decisions are made in November. By the end of December, the Government must release a report outlining its chosen policy option.

4. To support Cabinet's August decisions, we understand officials from the Ministry for Primary Industries and Ministry for the Environment are progressing the assessment of several options (including a processor-level hybrid levy). These will be compared against the Partnership's proposal (a farm-level split-gas levy) and the default option to include agriculture in the Emissions Trading Scheme (**NZ ETS**) at the processor-level (referred to as the NZ ETS backstop).

5. We see three critical decision points for you:
   a) Preliminary decisions on a pricing option in August for consultation;
   b) Final policy decisions on a pricing option in November/December; and
   c) Investment decisions on the regulator and IT systems (timing to be determined).

6. We will provide you advice ahead of these decision-points and engage with lead agencies throughout the process. **Annex 1** contains our summary forward plan.

Emerging focus areas for our advice

7. We suggest decision-makers remain open to a range of viable pricing options, including the NZ ETS backstop and how elements of the Partnership's proposal may be enhanced or desirable components incorporated into other options.

The NZ ETS backstop option

8. The processor-level NZ ETS backstop is a relatively low-cost option as the NZ ETS infrastructure required is largely in place through existing processor-level reporting obligations. This option could come into effect before 2025 through an Order in Council. However, the NZ ETS, as currently configured, does not enable split-gas pricing and defaults to including agriculture at the processor-level. These factors may result in weaker incentives for farm-level changes.

The Partnership's proposed option

9. The Partnership has recommended a farm-level levy that prices short- and long-lived gases separately and recognises and rewards on-farm efficiencies and mitigations. Its proposal also includes incentives for mitigation actions and on-farm sequestration (beyond sequestration recognised by the NZ ETS), which it proposes to use to offset levy costs to farmers. The Partnership also recommends that levy revenue is reinvested through a ringfenced agriculture fund in research, development, and extension services (including a dedicated fund for Māori landowners).

10. Based on our preliminary view of the Partnership's proposal, we have identified the following areas of focus.

11. **Achievement of our domestic climate targets.** The price signal to reduce gross emissions may be diluted by the degree of proposed offsets to the levies and a proposed price ceiling on the methane levy (until 2028). The resulting incentive may not be strong enough to elicit the change required to meet our methane targets.

12. The Partnership has assumed the waste sector will meet its sector sub-targets in line with the Climate Change Commission's ('the Commission') advice. There are high levels of uncertainty in the waste sector's ability to achieve these targets. Therefore, when accounting for the risk of a diluted price signal for agriculture and the uncertainty in the waste sector's ability to achieve its target, the Partnership's modelling may be optimistic in its assessment of total methane reductions to 2030.

13. **Distributional and credibility impacts.** The impacts of making any special dispensations for agriculture, as compared to other sectors, warrants careful consideration. There are distributional risks from shifting pressure and costs to

other sectors to meet our climate targets and risks to the credibility of a pricing system if its price signals are materially weaker than comparative NZ ETS prices.

14. **Recognition of sequestration not in the NZ ETS.** Sequestration currently not eligible for the NZ ETS does not count towards our domestic or international targets. It is not clear to us what extent the Partnership's proposal would reward farmers for vegetation already in place versus incentivising additional sequestration over and above this. Additionally, there may be additional complexity in administering a system which recognises these further categories of vegetation.

15. **Levy revenue and potential funding fragmentation**. The establishment of ringfenced funds for subsectors within agriculture risks fragmenting the funding landscape (although we support further investigation of funding options for Māori landowners). This would inhibit applying trade-offs at the sector level for funding decisions and the ability to fund large, cross-sector initiatives. In this event, to achieve funding for larger initiatives, either the levies would have to be raised or the Crown required to provide further funding.

Implementation risks

16. We consider there is significant risk to achieving the 1 January 2025 legislated milestone for implementing pricing. There is a trade-off between how tailored the pricing system is for agriculture and the complexities and costs of its establishment and administration. Implementation of an option outside of the NZ ETS will require the development of a bespoke pricing IT system and the stand up of a regulator for the system, which carries high levels of cost and schedule uncertainty.

s9(2)(f)(iv)

18. Regardless of the policy direction, we support actions to de-risk implementation (e.g. delivering a 'simple' system by 2025 before shifting to an end-state system). Through your discussions with Ministers, we suggest you reinforce the importance of mitigating delivery risk.

Fiscal implications

19. Initial work to develop an agricultural emissions pricing system received $6.3 million in Budget 2022. s9(2)(f)(iv)
s9(2)(f)(iv)

s9(2)(f)(iv)

21. The Commission's recent advice on agricultural assistance may have fiscal implications, if accepted. The Commission has recommended providing assistance to farmers where the Government expects material financial hardship to result from emissions pricing. The scale of potential assistance will not be clear until Cabinet selects a preferred pricing option. In general, there is a relationship between the speed of transition (and cost to farmers) and the quantum of assistance that might be required.

Next steps

22. We will aim to provide you with a Treasury Report in July outlining our advice on policy options developed by lead agencies and would welcome feedback on any specific areas you would like us to focus on in this advice. You may also wish to provide this aide memoire to the Associate Ministers of Finance, the Hon Dr Megan Woods and Hon David Parker.

Luke Crossen, Senior Analyst, Natural Resources s9(2)(k)
James Haughton, Manager, Natural Resources, +

Annex 1: Upcoming agricultural emissions pricing milestones

Milestones	Formal decisions required by you	Our planned advice
June • The Commission's advice on the readiness of the agriculture sector's progress towards meeting legislated milestones, and its assessment of farmers readiness for a farm-level emissions pricing system. **July** • Independent modelling report from Manaaki Whenua Landcare Research on the policy options.	None, but we suggest in conversations with your colleagues you reinforce the points raised in this paper.	July: A Treasury Report outlining our view of policy options, s9(2)(f)(iv) s9(2)(f)(iv), the Commission's advice, and independent modelling.
August • Cabinet makes policy decision for public consultation. s9(2)(f)(iv)	Decision by Cabinet on the preferred policy option for public consultation and the s9(2)(f)(iv) s9(2)(f)(iv)	A briefing on the preferred policy option.
September – October • Public consultation • Development of final policy advice.	None.	Briefing(s) as required.
November • Cabinet makes final policy decision.	Decision by Cabinet on the preferred policy option for public consultation.	A Treasury Report on the preferred policy option.
December • Government published report on agricultural emissions pricing. s9(2)(f)(iv)	s9(2)(f)(iv)	s9(2)(f)(iv)

TE TAI ŌHANGA
THE TREASURY

Treasury Report: Briefing for 20 June Meeting of the Climate Response Ministers Group

Date:	17 June 2022	**Report No:**	T2022/1304
		File Number:	SH-10-8

Action sought

	Action sought	Deadline
Hon Grant Robertson **Minister of Finance**	**Note** advice and talking points from Treasury and Te Waihanga for your participation in the CRMG meeting	20 June 2022

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
Tom Wilson	Senior Analyst, Climate Change	s9(2)(k) (wk)	s9(2)(g)(ii)	✓
Monique Cornish (for Te Waihanga)	Principal Policy Advisor, Climate Change, Te Waihanga	n/a		
Nicky Lynch	Manager, Climate Change	s9(2)(k) (wk)		

Minister's Office actions (if required)

Return the signed report to Treasury.

Forward this report to the Minister Responsible for the Earthquake Commission.

Note any feedback on the quality of the report

Enclosure: No

Treasury Report: Briefing for 20 June Meeting of the Climate Response Ministers Group

Executive Summary

There are three items on the CRMG agenda: the National Adaptation Plan (NAP), an update on the Climate Change IEB, and He Waka Eke Noa.

The **discussion on the NAP** is the main opportunity for CRMG to discuss proposed changes following consultation before the NAP returns to Cabinet for finalisation. A number of new actions are proposed. We recommend that if any of the proposed "additional actions" are included in the final NAP, they should be framed as areas for investigation rather than firm commitments. This is because the actions have not been assessed for policy merit, the capacity of agencies to deliver them is unclear, and funding should be considered in the Budget process.

We recommend three of the additional actions be prioritised for further investigation:

- **Action 1** on data provision. This is well suited to central government support but should be reframed as the current action title implies a funding pre-commitment.

- **Action 3** proposes interim regulation in the period before Resource Management reform, limiting development in high-risk areas. Stopping further development in high-risk areas should be a high priority. However, the feasibility of this work will need to be tested, as it would need to be both rapid and not impact delivery of Resource Management reform itself.

- **Actions 8 & 9** cover adaptation costs, funding and financing. We support further work in this area, but recommend this be combined into one action that firstly focusses on assessing the strengths and weaknesses of the *existing* cost sharing framework, because that work has not yet been done. Work on the case for any additional funding and financing mechanisms can follow.

The Treasury will provide follow up advice to confirm our proposed wording changes to Treasury actions in the final NAP. We expect minor changes to our flood insurance actions in the Economy and Finance Chapter, plus possible updates to our 'public investment' action.

Te Waihanga will provide follow up advice to confirm approval of several new actions for the Infrastructure Chapter, and removal of one previous draft action.

For the **second item on the Interdepartmental Executive Board** (IEB), we emphasise that the IEB's ability to prioritise, and reprioritise, climate policy work will be critical for its success. Te Waihanga have concerns that the infrastructure system may not be fully represented on the IEB and will provide further advice on the best way to fill that potential gap.

The **third item on He Waka Eke Noa** will provide a situation update and an overview of potential pathways to delivering a pricing system by 2025.

We recommend you support agencies continuing to explore different pricing systems, in addition to the He Waka Eke Noa Partnership's (the Partnership) proposal and Emissions Trading Scheme backstop (NZ ETS) option.

We suggest you highlight the need for the pricing system to provide an effective price signal capable of incentivising farm-level changes to help achieve our climate targets. You may wish to highlight the importance of ensuring the policy design of levy revenue recycling avoids fragmenting the funding landscape and avoids requirements for ongoing additional Crown funding. We also recommend you raise the importance of taking steps now to mitigate implementation risks and the need for this to be factored into policy design. We believe complexity and delivery risks are highest for farm-level pricing options.

Treasury will be providing you advice ahead of key decision points. The next formal decision-point will be in August, when Cabinet determines a preferred option for public consultation.

Recommended Action

We recommend that you:

a **note** the recommended talking points provided in the body of this report.

Nicky Lynch
Manager, Climate Change

Hon Grant Robertson
Minister of Finance

_____/_____/_____

Treasury Report: Briefing for 20 June Meeting of the Climate Response Ministers Group

Purpose of Report

1. The Climate Response Ministers Group (CRMG) is meeting on Monday 20 June. The agenda will cover three items:
   - National Adaptation Plan
   - Interdepartmental Executive Board for Climate Change, and
   - He Waka Eke Noa.

Item 1: National Adaptation Plan (Minister of Climate Change)

2. This item summarises the public feedback on the draft National Adaptation Plan (NAP), and asks Ministers to:

   - **Confirm** additional actions for inclusion in the final NAP and lead Ministers for each.
     - Any changes would be reflected in the new proposed "At a glance" booklet shared as Paper 2.

   - **Direct** officials to co-design indicators for the long-term adaptation goals with the Climate Change Commission.

Recommended talking points

Recommendation 1: Confirm additional actions for inclusion in the NAP and lead Ministers for each

s9(2)(g)(i)

- **Suggest** that a subset of actions with greater potential be carried forward for further investigation, as follows

- **Action 1 on data provision**. This is an area well suited to central government support and may assist groups who otherwise cannot find, or afford, data to inform their own risk management decisions. However, the title should change to avoid any pre-commitment of funding, and the scope, costs, and ownership needs clarification.

- **Action 3 proposes interim regulation** in the period before Resource Management reform, limiting development in high-risk areas and thereby reducing long term costs. However, the feasibility of this work needs to be tested, as it would need to be both rapid and not impact delivery of Resource Management reform itself. Ministers could consider shifting resource from the Climate portfolio to the Environment portfolio within Vote Environment to make the resourcing trade-offs transparent.

- **Actions 8 & 9 cover adaptation costs, funding and financing**. Submitters requested greater clarity on how and when central government will define a cost sharing framework. We recommend this be combined into one action that firstly focusses on assessing the strengths and weaknesses of the *existing* cost sharing framework, because that work has not yet been done. It should also connect with the Future of Local Government Review which examines local government funding and financing issues as a whole, and not just adaptation. Work on whether additional funding and financing mechanisms are needed can follow. The timing and ownership of this work also needs to be worked through.

Recommendation 2: Direct officials to co-design indicators for the long-term adaptation goals with the Climate Change Commission

- **Support**. Tracking progress towards long-term goals will be helpful for future NAPs.

Context

3. Submissions closed on Friday 3 June. Approximately 290 submissions were received. The CRMG slides provide a summary of key themes arising.

s9(2)(g)(i)

6. There are number of uncertainties that will need to be addressed during due diligence:

    - *Uncertain scope*: While the broad intent of the actions has been established, the detailed work to ensure they are feasible and will respond to a well-defined problem has not been done.

    - *Uncertain costs*. The fiscal costs are not yet known.

- *Central government capacity*. The capacity of agencies to carry out the additional work will likely require trade-offs in other priority areas due to capacity constraints (there are already 87 current actions in the NAP and another 20 proposed). To date there has been no equivalent exercise to see what existing NAP actions could be *deprioritized* in response to submissions.

- *Recipient capacity*: The ability of recipients to absorb the proposed support is highly constrained. This particularly applies to local government and Iwi/Māori who have repeatedly raised concerns about their capacity to engage in multiple overlapping reform processes.

- *Risks to RM reform delivery:* Adding additional work streams into the Resource Management reform programme increases delivery risk due to capacity constraints and uncertainty around the trade-offs required.

Three of the "additional actions" could be prioritised

7. We suggest that the following three actions be prioritised for further investigation.

Action 1. "Agree Government will fund publicly available climate hazard data"

8. We support investigation of increased central government provision of climate hazard data to other groups to help them understand and manage their own risks.

9. The current language directly commits Crown funding outside the Budget process and before scoping is complete. We would suggest framing the action as "*investigate making more climate hazard data publicly available*".

10. We support this because:

    - There is anecdotal evidence that some groups, including some councils, are not accessing data that would support their risk management decisions, because they are not aware of it, or can't afford it. Other councils have greater capacity and often commission their own expert analyses.

    - There are likely to be benefits from the availability of a nationwide data prepared on a consistent basis by a trusted source: as well as making it easier for local government to access information to enable more effective planning and risk management, consistent data on risk levels is also likely to be a critical foundation for the development of approaches to issues like managed retreat.

    - Information asymmetries are a market failure often suited to a central government intervention. Providing information has relatively low fiscal risk or moral hazard, as the incentive remains on asset holders to decide on their own response to the information.

11. As noted in the paper, work would be required to properly define the scope, funding and Ministerial ownership of this work before confirming. Providing guidance to ensure the data is used appropriately also needs to be considered.

s9(2)(f)(iv)

Action 3. "… investigate the development of statutory options to address climate adaptation and natural hazard risks…"

13. We support the intent of this action to provide clear direction to local government to prevent new development or intensification in high-risk areas during the transition period to the new Natural and Built Environments Act (NBA).

14. There is anecdotal evidence that high risk development and intensification is ongoing, but implementation of the changes planned through Resource Management reforms will take a number of years. Given that, we see merit in investigating whether there are measures that could be taken in the interim.

15. As noted in the paper, this work would need to be completed quickly to make a difference before the NBA commences. The feasibility is yet to be determined.

16. We note that preventing development in high-risk areas is not itself cost free; for example, reduced development in high risk areas could impact land markets and housing supply. Increasing land supply in safer locations may need to be considered.

17. If additional resourcing is needed to progress this work, Ministers could consider shifting resource from the Climate portfolio to the Environment portfolio within Vote Environment to make the resourcing trade-offs transparent and mitigate risks to NBA and Spatial Planning Act delivery/implementation.

Actions 8 & 9: "Agree to develop a model of the costs of climate change" and "Publish the work programme for exploring additional interventions to mobilise investment by December 2022"

18. Submitters emphasised their desire for central government to say when and how it would define a "cost sharing framework" for climate adaptation. We support work in this area.

s9(2)(g)(i)

20. We considered this actively with the Ministry for the Environment in earlier stages of the development of the draft NAP. Our overall view at this stage is below.

s9(2)(f)(iv)

- Our view is that the best way forward is to first properly assess the strengths and weakness of the current cost sharing framework. This would identify more clearly whether there is a case for roles and responsibilities to change or be clarified in light of growing risks, before considering the need for additional funding and financing mechanisms (the Treasury advocated for this assessment in the draft NAP but the work had not been done at that point).

- The current cost sharing framework puts local government at the centre of managing and funding natural hazard and climate risk, with supporting roles from central government, asset owners and the insurance and banking industries.

- This current framework has endured and operated successfully in at least some instances, aligning political accountability and resourcing choices at the local level.

s9(2)(f)(iv)

- This assessment should connect to the Future of Local Government Review which is looking at funding and financing across *all* local government cost pressures together, not just climate adaptation in isolation.

s9(2)(f)(iv)

21. We recommend the two actions proposed in this area be combined under a single title "*Publish a timeline for updating the cost sharing framework covering natural hazard and climate risk, taking into account the outcomes of the Future of Local Government Review*". A target date could be set following further planning.

22. We support further work on quantifying adaptation costs (climate impact costs, costs of adaptation itself, fiscal and economic, direct and indirect). We recommend that this is reflected in the description of the action rather than a headline reference, because the work would be ongoing rather than a single product. The feasibility of comprehensive modelling is uncertain, and there are likely to be costs involved that are not funded at this stage.

23. We are keen to improve our understanding adaptation costs, s9(2)(f)(iv) . We also plan to update the analysis in our 2021 Long Term Fiscal Statement on the fiscal and economic impacts of future climate change impacts. s9(2)(f)(iv)

24. Finally, we do not recommend headline reference to 'mobilising investment' because mobilising public finance is already fundamental to the cost sharing work noted above, s9(2)(f)(iv)

Other actions offer less potential for "sharper deliverables in the next two years"

25. We consider the remaining seven actions offer lower potential because their impact is less clear or they may take too much time. The proposed sequencing of work is often unclear across resource management reform, local government reform, building standards and risk data. We reiterate that these are initial judgements and may change with more information and time for assessment.

We propose small changes to the Treasury led actions in the NAP, including flood insurance work

26. Treasury and the Ministry for Business, Innovation and Employment (MBIE) jointly drafted the "Economy and Finance" Chapter of the draft NAP. Most feedback was at a high level rather than directed at specific actions.

27. We will provide follow up advice to your office to confirm our proposed wording changes to Treasury actions in the final NAP. We expect minor changes to the framing of the Economy and Finance Chapter including:

    - Aligning the outcome description to the economic strategy language of high wages, low emissions and economic security.

    - Including a new box to describe how the actions will support vulnerable New Zealanders.

28. We have also adjusted the wording of the flood insurance action to incorporate feedback on the potential role of insurance as a price signal to encourage adaptation, and to acknowledge insurance is seen as just one of many levers responding to flood risk.

29. s9(2)(f)(iv)

30. Flood insurance work is continuing, including ongoing engagement with insurers, banks, iwi, local government and academics.

31. We will provide further advice to the Minister of Finance and the Minister responsible for the Earthquake Commission in mid-July.

32. The Treasury-led action on public investment, within the “System-wide” chapter, may change following CRMG discussions, depending on where responsibility for further work lies. We will provide further advice in advance of Ministerial consultation to ensure you are comfortable with the final wording.

Te Waihanga propose new actions for the Infrastructure Chapter

33. A summary of submission feedback on the Infrastructure Chapter and Te Waihanga’s response is attached in Annex 1.

34. In response to this feedback, Te Waihanga proposes the following changes to the Infrastructure Chapter. The changes are summarised below, with further detail provided in Annex 2. New actions, and any other material changes to existing actions will be confirmed with you in advance, or as part of, Ministerial Consultation on the final NAP.

- New action: Embed nature-based solutions as part of the response to reducing transport emissions and improving climate adaptation. Lead: Waka Kotahi and the Ministry of Transport.
- New action: Develop and implement an adaptation plan for the New Zealand Defence Force’s infrastructure. Lead: NZDF
- New action: Develop and implement a Transpower adaptation plan. Lead: Transpower
- New action still under discussion: inclusion of the Commerce Commission’s work on price-quality paths for energy distribution.
- Action removed: Based on advice from HUD and MFE, the work on infrastructure funding and financing as part of the urban growth programme will be removed from the Infrastructure Chapter. Reference to the urban growth programme will instead be made in the final version of the Homes, Buildings and Places Chapter.

Item 2: Interdepartmental Executive Board for Climate Change

35. We understand this item will provide Ministers with an update on the formalisation of the Climate Change Chief Executives as an Interdepartmental Executive Board.

36. Following Cabinet agreement to establish the group of Climate Change Chief Executives (Climate CEs) as a new Interdepartmental Executive Board (IEB, or the Board) earlier this year, work has progressed to transition the Climate CEs into an IEB. The Board will be legally formalised through an Order in Council in late July.

37. The core purpose of the Board is to coordinate implementation of actions and strategies; and to monitor, report and advise on progress against emissions budgets, sector sub-targets and overall implementation of the Emissions Reduction Plan (ERP). It is also meant to advise on how to respond to the results of this monitoring and reporting.

38. In our view, it is most important for the IEB to focus on the things that are not already within the core remit of individual agencies and where there is particular value in leveraging a focused cross-agency approach. The IEB's ability to prioritise and reprioritise will be critical to its ultimate success.

39. Taking the time upfront to establish clear priorities and streamlined processes for functions such as monitoring and advising on progress against sector sub-targets will be important components of setting the IEB up for success.

Item 3: He Waka Eke Noa (Ministers of Agriculture and Climate Change)

40. This item provides an update on the policy development process, an opportunity for Ministers to discuss the Partnership's proposal for agricultural emissions pricing, and an overview of potential pathways to delivering a pricing system by 2025.

41. On 31 May 2022, the Partnership delivered its final report on agriculture emissions pricing. In parallel, the Climate Change Commission ('the Commission') also provided its report on assistance for agriculture from emissions pricing to the Ministers of Agriculture and Climate Change. We provided you with an aide memoire outlining Treasury's preliminary view on the Partnership's proposal and our proposed plan to advise you on agriculture emissions pricing [T2022/1288 of 9 June].

Recommended talking points

- **Discuss** with Ministers and officials the importance of:
  - Progressing **competing viable policy options** through analysis to support informed trade-off decisions by Cabinet. This should include an analysis of whether the Partnership's proposal could be enhanced.
- **Mitigating implementation risk** for implementing agriculture emissions pricing by 1 January 2025. Specifically, you may wish to:
  - Reinforce the importance of agencies and industry having robust implementation plans for achieving milestones

s9(2)(f)(iv)

- You may wish to **signal** that the Partnership's proposal presents several challenging trade-offs and risks. Specifically:

- The **price signal may be insufficient** to elicit the necessary level of change required to achieve our methane targets due to the proposed range of offsets and a proposed price ceiling for methane (until 2028).
- Levies, if set too low, may be **insufficient to cover the cost** of administration, necessitating further Crown funding in the early years of the scheme.
- A weak price signal for agriculture may **reduce the credibility** of the pricing system and create **additional pressure for other sectors** (including forestry offsets) to meet our climate targets or put the achievement of them at risk.
- Recognising sequestration not in the NZ ETS may support actions **that lack scientific credibility** and **do not contribute** towards our climate targets.
- A **fragmented approach to recycled levy revenue** should be avoided to preserve optionality for its use and avoid the need for further Crown funding.
- The governance approach proposed by the Partnership may **risk regulatory capture**, given their recommendations to have industry representatives on a governing board responsible for recommending levy prices.

Timelines and decision points

42. We see **three critical decision points for you** in the upcoming process:
    a) Preliminary decisions on a pricing option in August for consultation;
    b) Final policy decisions on a pricing option in November/December; and
    c) Investment decisions on the regulator and IT systems (timing to be determined).
43. Treasury will provide supporting advice to you ahead of these points. We will also be engaging closely with agencies throughout the process.

Potential options that may be discussed

44. We understand lead agencies are progressing analyses of several different pricing options, including a **processor-level NZ ETS backstop,** a **farm-level split gas levy** (the Partnership's proposal), and a **processor-level hybrid levy**. **Annex 2** contains a summary of Treasury's initial comments on these options.

45. We understand that the Minister for Climate Change may also raise a **methane quota system** or a **split-gas variant of the NZ ETS** as additional options to explore. We have not seen any detail on these proposals.

46. Treasury has not identified nor advised on a preferred pricing option. We recommend you support agencies advancing multiple viable policy options, including the NZ ETS backstop and the Partnership's proposal, to inform appropriate risk and trade-off decisions. In considering the Partnership's proposal, lead agencies should consider whether the proposed design could be amended or enhanced to mitigate officials' and ministers' concerns.

Challenges implementing a pricing system by 2025

47. At the meeting we see **value in you raising the importance of feasibility as a critical success factor for any policy option**. Our view is that there is significant risk to achieving the 1 January 2025 legislated milestone for implementing pricing. This risk is highest for options outside of the NZ ETS backstop (as bespoke IT systems, new primary legislation, and regulatory structures would need to be established) and for farm-level options (due to logistical challenges identifying and registering farms and uplifting capability of 23,000 farms to comply).

48. Wherever possible, policy design and implementation planning should seek to de-risk the 2025 milestone. This could be achieved by considering transitionary arrangements *within* a chosen pricing scheme (e.g. delivering a simplified/streamlined option for 2025). The chosen pricing system could then be enhanced over time, increasing its effectiveness. s9(2)(f)(iv)

49. s9(2)(f)(iv)

The Commission's advice

50. The Commission's recent advice on agricultural assistance noted that financial assistance could be appropriate to avoid material financial hardship across the agriculture sector (or subsectors that face additional barriers to reducing emissions or are otherwise at greater risk of experiencing financial hardship). The Commission recommended pairing higher emissions prices with a rebate based on production output. Combining a higher emissions price with a rebate would provide a stronger incentive to reduce emissions intensity, while also mitigating other risks such as emissions leakage.

51. The Commission will provide second report to the Ministers of Climate Change and Agriculture by the end of June 2022 assessing farmer readiness to measure and manage their emissions by 1 January 2025. The report will also assess the Partnership's and agencies' readiness to implement a farm-level pricing system by 2025.

Annex 1: Te Waihanga summary of submissions on the NAP Infrastructure Chapter

Key themes from submissions:

- Most submitters agreed with the outcome, objectives and actions set out in the draft infrastructure chapter. The following key themes have been identified, but further analysis of submissions will continue in the coming week.
- ***Data, tools and guidance to support adaptation***: Of the identified critical actions, all were supported with most support given to two of Te Waihanga's actions:
    - The development of a methodology for assessing impacts on physical assets and the services they provide
    - Scoping a resilience standard or code for infrastructure.
- ***Coordination across and within government***: Many submitters noted that coordination between infrastructure developers, planners, and various levels of government is essential, especially as significant reform occurs, namely the Three Waters reform.
- ***A sense of urgency and mandatory requirements***: A number of submitters called for greater urgency in the development of guidance, and the need to move from "guidance" to "regulation" or "mandatory action".
- ***Funding for adaptation***: Many submitters called for support to fund infrastructure resilience, and to develop local, distributed infrastructure solutions (particularly energy) in their communities.
- ***The role of iwi / Māori***: A few submitters referred to current reforms, such as the Resource Management reform, as potential mechanisms to ensure holistic, te ao Māori perspectives and mātauranga Māori are appropriately included in infrastructure planning, design and operation.

Te Waihanga's response to submissions:

- ***Data, tools and guidance to support adaptation:*** Submitters provided feedback as to what could be included in the guidance documents Te Waihanga have committed to develop for infrastructure. Te Waihanga will take the suggestions into consideration as we move into implementation.
- ***Leveraging existing and future regulation***: Te Waihanga will continue to work with s9(2)(f)(iv) to ensure that we leverage, and integrate with, existing and potential future regulatory instruments to help give effect to this guidance and the objectives of the NAP for infrastructure. This narrative will be strengthened in the final NAP.

- ***Funding for adaptation***: We do acknowledge that funding will be an ongoing issue for the sector. The question will be partially addressed through item 8 (*agree to develop a model of the costs of climate change*). Further, Te Waihanga are working with the Commerce Commission to include their work on price-quality paths for energy distribution into the final NAP. HUD and MfE consider that it is not appropriate for the work on infrastructure funding and financing as part of the urban growth programme being included in the NAP in its current form. This is because a cross-cutting approach should be taken to considering institutional barriers and incentives for all types of adaptation responses, rather than considering funding for adaptation-related infrastructure in isolation. The action in the draft Infrastructure Chapter will be removed, and reference to the urban growth programme will be made in the final Homes, Buildings and Places Chapter.
- ***The role of iwi / Māori:*** Te Waihanga will strengthen the existing narrative on the guidance actions to ensure (not explore) an equitable approach for Iwi/Māori interests and communities of interest least able to adapt.

Other additions to the Infrastructure Chapter

- ***Additional organisations signaled their desire to be included in the NAP***: As part of consultation, a number of asset owners signaled that they wish to have their adaptation actions included in the NAP. As a result, the adaptation programs of Transpower and the New Zealand Defence Force will be included in the final NAP.
- ***Nature-based solutions***: the action to embed nature-based solutions as part of the response to reducing transport emissions and improving climate adaptation and biodiversity outcomes will be included in the final NAP. This is the same action that was included in the ERP.
- ***Industry capability***: the remains a potential gap, and Te Waihanga supports MBIE's inclusion of their industry capability programme developed as part of the ERP in the final NAP. This will be included as a new action in the Homes, Buildings and Places Chapter.

Annex 2: Initial Treasury comments on He Waka Eke Noa pricing options

Potential pricing option	Initial Treasury comments
NZ ETS Backstop • Default option to include agriculture in the NZ ETS at the processor-level • Price incentive would be based on prevailing NZ ETS market prices for New Zealand Units (NZU) • Sequestration would be limited to categories recognised under the NZ ETS • Revenue would be recycled (e.g. back into the NZ ETS)	• The infrastructure needed for implementing the NZ ETS backstop option at the processor-level is largely in place due to existing processor-level reporting obligations. • This option could come into effect before 2025 via an Order in Council. • The industry would still require support to build capability to comply. • We believe delivery risk for the NZ ETS processor-level option is lower than for farm-level options. • The NZ ETS, as currently configured, does not allow for split-gas pricing (i.e. pricing of methane and long-lived gases separately). Considering this, and the default processor-level point of obligation for the NZ ETS, this option may provide weaker incentives for farm-level change.
Farm-level split-gas levy (The Partnership's proposal) • A farm-level levy that prices short- and long-lived gases separately and recognises and rewards on-farm efficiencies and mitigations. • Incentives for mitigation actions and on-farm sequestration (beyond sequestration recognised by the NZ ETS), which it proposes to use to offset levy costs to farmers. • Levy revenue is reinvested through a ringfenced agriculture fund in research, development, and extension services	• A stronger price signal generated from a farm-level pricing may be eroded by the range of offsets proposed (from sequestration and incentives for mitigation actions) and a proposed price ceiling for methane (until 2028). This may not result in the level of price incentive required to elicit the degree of on-farm changes needed to achieve our domestic methane targets. Our 2030 methane target would be most at risk. • We understand that some of the vegetation the Partnership is proposing to reward would not count towards our domestic or international targets. While there may be other reasons (including biodiversity and water quality benefits) for incentivising such vegetation, we are concerned that doing so would erode the incentive to reduce gross emissions. We also have questions about the scientific credibility of rewarding some of the types of vegetation the Partnership is proposing. It is also not clear to us what extent the Partnership's proposal would reward farmers for vegetation already in place versus incentivising additional sequestration over and above this. • The impacts of providing agriculture special dispensation, as compared to other sectors, warrant careful consideration. There are distributional risks from shifting pressure to other

(including a dedicated fund for Māori landowners).	sectors to meet our climate targets and risks to the credibility of a pricing system if its price signals are materially weaker than comparative NZ ETS price levels. • The Partnership recommends revenue be recycled in-line with an investment strategy determined by a 'System Oversight Board', with industry representation. It is important that this approach does not fragment the funding landscape at the subsector level. Applying a subsector-level approach would inhibit the ability to apply trade-offs at the sector level and increase the risk that additional Crown funding would be required to support larger-scale, sector-wide initiatives. • A low levy price, considering the range of offsets applied, increases the risk of insufficient net revenue to reinvest into the sector to develop and incentivise uptake in low emissions practices and technologies. • The proposed System Oversight Board may risk regulatory capture. The Partnership' have recommended a governance board for the administrating entity with industry representation. While industry should have input on the usage of levy revenue and be consulted on setting levy rates, decisions for these items should rest with Ministers.
Processor-level hybrid levy • Enables separate levies to be set for short- and long-lived gases. • Levies would be calculated at the processor/manufacturer level. • Rewards the same categories and sequestration rates as farm-level split-gas levy via a Sequestration Management Contract. • Revenue may be recycled in a similar fashion to the Partnership's proposal.	• This was an option publicly consulted on, but subsequently rejected, by the Partnership due to preference by industry for a farm-level solution. • We understand officials from lead agencies are retaining this option for further analysis. • This option would be lower cost and simpler to administer than a farm-level split-gas levy. • Complexity of implementation remains a risk with this option (e.g. potential requirements to establish a regulating entity or a bespoke IT system) but would be lower than for farm-level options (as there are significantly fewer processors who would be required to comply). • It would also allow split pricing of short- and long-lived gases. • However, it has reduced ability to incentivise farm system efficiencies as it relies on pricing at the processor-level.

TE TAI ŌHANGA
THE TREASURY

Treasury Report: Agricultural Emissions Pricing: Treasury Advice on Policy Options

Date:	21 July 2022	**Report No:**	T2022/1303
		File Number:	AC-4-5-21

Action sought

	Action sought	Deadline
Hon Grant Robertson **Minister of Finance**	**Note** the contents of this report. **Raise** the discussion points at the CRMG meeting on 29 July. **Refer** this report to the agreed Ministers.	29 July 2022

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
Luke Crossen	Senior Analyst, Natural Resources	s9(2)(k)	None (mob)	✓
Nicky Lynch	Manager, Climate Change		s9(2)(g)(ii) (mob)	

Minister's Office actions (if required)

Return the signed report to Treasury.

Refer this report to the agreed Ministers.

Note any feedback on the quality of the report

Enclosure: No

Treasury Report: Agricultural Emissions Pricing: Treasury Advice on Policy Options

Executive Summary

In September, Cabinet will decide on a policy option(s) to publicly consult on for agricultural emissions pricing. This is a pivotal opportunity to institute a pricing system grounded in **sound economic principles**, while also considering key elements and trade-offs with **feasibility** and **acceptability**. This report provides you advice on shortlisted policy options, including the changes we recommend to options as currently tabled.

Incentivising the agriculture sector to reduce its emissions is a necessary step to achieving the Government's vision of a resilient high wage, low emissions economy [T2022/1342 refers]. Despite agriculture accounting for half of our emissions, these emissions are currently unpriced, which is in tension with this vision. This also increases the size of the potential shortfall between domestic emissions reductions and the level of our international commitments, generating a fiscal risk. We see the most important action to mitigate these matters is to establish a foundational pricing system now that can be enhanced over time.

At the June Climate Response Ministers Group (**CRMG**) meeting the *He Waka Eke Noa* Partnership's ("the Partnership") proposal and transitional processor-level hybrid levy were short-listed as options alongside the New Zealand Emissions Trading Scheme (**NZ ETS**).

The NZ ETS is grounded in sound economics (Treasury preferred)

From an economic perspective, our preferred approach is one that prices all emissions in a single market that recognises the relative externalities of these emissions and supports whole-of-economy trade-offs.

As a whole-of-economy scheme, we see the NZ ETS as most closely aligning with our recommended approach. A robustly functioning NZ ETS delivers a strong signal to all sectors of the economy that can incentivise efficient investment to reduce net emissions in a cost-effective manner. A cost-effective transition maximises the resources available to achieve our broader objectives. The market-set price of units better enables an economically efficient price to be set in comparison to the setting of a levy. s9(2)(f)(iv)

s9(2)(f)(iv)

If a levy is pursued, we recommend critical changes to the options tabled

We acknowledge that Ministers will also want to consider feasibility and acceptability considerations in addition to what is economically most preferable. However, we would suggest it is critically important that any pricing system retains two core elements of a first-best economic approach:

- Generation of a **salient price signal** that can support cost-effective emissions reductions through **whole-of-economy trade-offs**, and
- Ensuring any **price is set based on underlying economic rationale,** with acceptability or other political economy-related concerns addressed through the use of complementary measures (such as transitional assistance).

The Partnership has proposed separate levies for short- and long-lived gases, incentive payments to drive uptake of on-farm technologies, and a separate sequestration scheme from the NZ ETS. We see significant risk in this proposal as written and do not consider it to meet the minimum requirements outlined above.

If Ministers wish to proceed with a levy option, at minimum we strongly recommend:

- **Removing the sequestration scheme from the proposal and channelling sequestration via the NZ ETS** (**essential**). The proposed scheme risks undermining the role that the NZ ETS plays in driving efficient net emissions trade-offs across the economy. It also generates significant equity concerns and carries a high risk of rewarding sequestration that will not contribute towards our targets. The Climate Change Commission ("the Commission") has also strongly recommended the sequestration scheme be removed from the proposal, and
- **Ensuring governance and levy-setting are independent and effective to set a sufficiently strong marginal price that incentivises the scale of change needed to meet our targets** (**essential**). Independence would be achieved by removing industry representation from the governance board (and instead fostering sector inclusion using an advisory board or equivalent mechanism). To facilitate setting an effective marginal price, the Commission could advise on a recommended levy price at the economically efficient level or levy prices could be tethered to the NZ ETS carbon price.

To further strengthen the proposal, we also recommend:

- **Pricing fertiliser at the processor-level** through the NZ ETS (**important**), in alignment with the Commission's advice,
- **Readjusting the balance of incentives** from reliance on incentive payments for low emissions technologies to pairing a strong marginal price with appropriate complementary support mechanisms, thereby reducing reliance of the system on potentially optimistic forecasts for as-yet-unavailable technologies (**important**), and
- **Avoiding hypothecating levy revenue at a subsector level** to avoid sub-optimal investment (**desirable**).

If essential changes to levy options cannot be made, our recommendation is to include agriculture in the NZ ETS. At minimum, the NZ ETS backstop should be retained in options analysis for comparative purposes.

Implementation is a key risk

Implementing a farm-level levy option carries significant risk. While the Commission has concluded with high confidence that the sector will be ready for a streamlined version of a farm-level levy by 1 January 2025, it was unable to assess government readiness due to insufficient evidence. s9(2)(g)(i) s9(2)(g)(i) . Our recommended changes to the Partnership's proposal help simplify scope, but significant residual risk remains. Farm-level solutions carry particularly high levels of complexity given the number of users to be onboarded. All options outside of the NZ ETS require establishment of regulatory structures, new primary legislation, and bespoke technology – all within the context of a constrained ICT labour market and parallel transformations across industry and government.

There are implementation choices you can influence now to help mitigate delivery risk: s9(2)(f)(iv)

s9(2)(f)(iv)

Targeted assistance may improve the acceptability of the system

Transitional assistance may help achieve a just and equitable transition and support the resilience of the agricultural economy – recognising that the agriculture sector is trade exposed and many of its international competitor markets may not face similar domestic emissions pricing policies. However, the risks of emissions leakage are uncertain, and we support the Commission's conclusion that any assistance provided solely on this basis should be grounded in clear evidence. s9(2)(f)(iv)

s9(2)(f)(iv)

Recommended Action

We recommend that you:

- **note** pricing agricultural emissions is a necessary step to achieving the Government's vision of a resilient high wage, low emissions economy,
- **note** a good pricing system should be grounded in sound economics, while considering trade-offs with feasibility and acceptability,
- **note** we suggest placing priority on a establishing a base pricing capability that can be enhanced to be more effective over time,
- **note** as the options are written, The Treasury's preferred option is for agriculture to be included in the NZ ETS at the processor-level,
- **note** that if a levy option is pursued, the Treasury's view is that there are critical risks to address with the Partnership's proposed sequestration scheme, governance arrangements, and approach to setting levies,
- **note** the significant implementation risks with a farm-level levy and that Ministers can act now to mitigate these risks,
- **note** that targeted assistance may be required to facilitate a just and equitable transition for the sector and to support its resilience,
- **raise** the discussion points in this report at the 29 July CRMG meeting, and
- **refer** this report to the:

Prime Minister, Rt Hon Jacinda Ardern *Refer/not referred.*	Associate Ministers of Finance, Hon Megan Woods, Hon Kiri Allen, and Hon David Parker *Refer/not referred.*
Minister of Agriculture, Hon Damien O'Connor *Refer/not referred.*	Minister of Climate Change, Hon James Shaw *Refer/not referred.*

Nicky Lynch
Manager, Climate Change

Grant Robertson
Minister of Finance

_____/_____/_____

Treasury Report: Agricultural Emissions Pricing: Treasury Advice on Policy Options

Purpose of the report

1. There is a CRMG meeting on 29 July 2022 and agricultural emissions pricing is an agenda item. This item will seek policy direction from Ministers for a preferred option to publicly consult on, following formal Cabinet agreement in late September.

2. This report outlines Treasury's recommended approach for selecting a pricing option for public consultation, our recommended principles for a robust and enduring pricing system, and our evaluation of the three short-listed policy options against these principles. We have also provided an analysis of potential implementation pathways.

It is critically important to price agricultural emissions

The absence of agricultural emissions pricing is a key policy gap

3. The Treasury and MBIE recently provided you with joint advice on areas to drive progress towards the Government's economic vision of a resilient high wage, low emissions economy [T2022/1342 refers]. The first Emissions Reduction Plan (**ERP**) has also laid the foundations for New Zealand's transition to a low-emissions economy. Giving effect to both the ERP and the Government's broader economic strategic vision will require incentives to be aligned across the economy to drive net emissions reductions down.

4. The agriculture sector currently accounts for 50% of New Zealand's gross emissions and over 90% of our methane emissions. Reductions in agricultural emissions will be essential to meet our targets. However, these emissions are currently unpriced, which is in tension with the Government's economic vision and the first ERP.

5. The absence of emissions pricing means the agriculture sector is receiving an implicit subsidy by not facing the full costs of its production. This implicit subsidy also risks a lack of meaningful action by the sector to actively reduce its emissions, which shifts pressure to other sectors to meet our climate targets. This pressure creates a risk to the resilience of the broader economy.

6. In addition, the lack of incentive to reduce agricultural emissions in the near-term increases the size of the fiscal risk presented by the shortfall between anticipated domestic emissions reductions and the level of our international commitments under our 2030 Nationally Determined Contributions (**NDC**). Additional reductions by the sector could lessen the volume of mitigation we are likely to have to procure from overseas, at a currently unknown cost.

7. More broadly, the lack of inclusion of agriculture within New Zealand's emissions pricing system means that the market is less able to drive efficient investment across the economy to drive our net emissions levels down. This has implications for the cost of our overall transition and an opportunity cost for achieving other Government priorities.

8. We acknowledge that the agriculture sector competes in international markets where competitors may not currently face similar domestic obligations to reduce emissions.

Given this, it is reasonable to take a transitional approach towards full emissions pricing for the sector and complement pricing policy with additional measures where appropriate that do not hinder the marginal price incentive.

9. However, we view it as critical to **establish a foundational pricing system now** that can be built on and enhanced over time to drive deeper change. This could be part of an existing pricing system (i.e. the NZ ETS) or a separate system. To support an adaptable system, we suggest avoiding 'locking in' features which constrain future decision-making or reduce a system's durability. To achieve broader economic objectives, our view is a system's design should reflect sound economic principles.

Now is an opportune time to influence the direction of pricing policy design

10. Lead agency officials were directed at the June CRMG meeting to focus analysis on three pricing options for the agriculture sector: the processor-level **NZ ETS backstop** ("option 1"), a **farm-level split-gas levy** (referred to as "the Partnership's proposal" or "option 2"), and a transitional **processor-level hybrid levy** ("option 3"). Officials were subsequently directed to explore a **simple farm-level levy**, a streamlined version of the Partnership's proposal. We have analysed a simple farm-level levy option as part of our assessment of the Partnership's proposal. **Annex 1** provides further detail on the key design features of the proposed policies.

11. Officials were also directed to report back to Ministers by the end of June with a decision-making framework to assist Ministers with selecting a preferred policy option.

12. This is an opportune time to influence the direction of policy design ahead of Cabinet's September decision on public consultation. The Government must release a report by the end of 2022 outlining how agricultural emissions will be priced. Cabinet is expected to make final policy design decisions in February 2023.

Our approach to assessing policy options

13. We have considered whether the options under consideration reflect **sound economic principles**, and how these might need to be traded-off against **feasibility** and **acceptability**. **Annex 2** provides additional detail on each principle. **Annex 3** summarises our analysis of options against principles.

14. An **economic** pricing system will help support an efficient shift towards a resilient, high-wage, low-emissions economy. In our view, it is critical that any agricultural emissions pricing system reflect the core elements of what we view to be a first-best economic approach. Specifically, that it:

    a Generates a **salient price signal** that can support cost-effective emissions reductions through enabling **whole-of-economy trade-offs**, and

    b Ensures any **price is set based on underlying economic rationale** with acceptability or other political economy-related concerns addressed through the use of complementary measures, rather than hindering the primary price signal.

15. The **feasibility** of a system is also important. A system should be able to be implemented within an appropriate risk profile at a reasonable cost, be practical to administer and comply with, and avoid exposing the Crown to undue fiscal risk.

16. The **acceptability** of a pricing system, including its distributional impacts, is a key factor for the durability of a policy. Analysis of acceptability may involve considering

trade-offs between subsectors (e.g. varying impacts of pricing on land use change for sheep and beef versus dairy) and across sectors (e.g. perceptions of fairness within agriculture and policy credibility to other sectors).

Option 1: Pricing agricultural emissions via the NZ ETS (**Treasury preferred**)

The NZ ETS most closely resembles a first-best pricing approach…

17. In our view, the NZ ETS option is most consistent with the economic principles described above. Inclusion of agriculture in the NZ ETS would establish a single, economy-wide market for emissions pricing where the relative costs of abatement actions could be traded off across all sectors to drive cost-effective behaviour and investments across the economy that reduce net emissions. The use of market forces by the NZ ETS to set the price (within the bounds of Ministerially-set price controls) allows it to set more robust price signals aligned with the level of incentive necessary to drive our net emissions down than the short-listed levy options.

18. Inclusion of agriculture in the NZ ETS at 95% free allocation (the backstop) represents a significant free allocation of units, which could erode the market's ability to set a robust price signal. However, free allocation can be adjusted over time to bring the agriculture sector more in-line with the treatment of other trade exposed sectors of the economy that also face risks of emissions leakage. To address broader political economy concerns, including acceptability to the sector, we would instead recommend using targeted complementary measures, rather than embedding an approach that hinders the economy-wide NZ ETS price signal.

19. We understand from lead agency modelling undertaken by Manaaki Whenua Landcare Research Limited (**MWLR**) that the NZ ETS overachieves against 2030 targets, even under low carbon price assumptions at 90% free allocation. This is primarily driven by sheep and beef conversion to scrub and the uptake of mitigation technologies.

20. The NZ ETS does not inherently assign a preference to any particular outcome or balance of gross versus net emissions. However, based on the relative cost of available reduction or removals activities and the ability for sequestration to offset emissions liabilities, the NZ ETS is the system that is best placed to deliver on our net emissions reductions targets. While theoretically this may create a slight tension with our domestic gross methane reduction targets, MWLR modelling indicates that the NZ ETS option would still overachieve our gross domestic methane targets.

21. Finally, the NZ ETS backstop is significantly more feasible to implement by 1 January 2025 than other options as much of the existing system infrastructure is in place and processors currently report their emissions. This is of significant benefit with respect to what is ultimately important – that agricultural emissions *are* priced.

… but there are trade-offs to consider, particularly with acceptability

22. There are acceptability trade-offs with the NZ ETS option for Ministers to consider. The agriculture sector has expressed a strong preference for pricing outside the NZ ETS. If agriculture were included in the NZ ETS, this may have implications for the long-term durability of agriculture emissions pricing and, consequently, the ability to drive progress towards long-term targets (i.e. if the scheme were to be determined unacceptable and removed in the future). The counterpoint is that the inclusion of agriculture in the NZ ETS would mean there is parity with the treatment of emissions from other sectors.

23. The sector has also raised price volatility as a key concern given the sector is trade exposed. Price stability could be supported through cost containment measures in-built into the NZ ETS and targeted levels of free allocation. We see broader concerns of acceptability as best dealt with through complementary measures outside the NZ ETS.

24. A perfectly economic solution would price livestock emissions at the margin (i.e. the farm-level). However, agencies and the sector have expressed concern over the ability for the NZ ETS to facilitate transition to a farm-level solution in future. There may be feasibility challenges for farmers interacting with the NZ ETS (e.g. their capability to trade in New Zealand Units). While enhancements to system interfaces may go some way to addressing this, our view is there would be residual risk that this pathway may not allow transition to a farm-level solution in future.

In discussing an NZ ETS backstop option at the CRMG, we recommend that you note:

- We believe this option best aligns with the principles of sound economics and will best allow for economy-wide trade-offs and an economically efficient price.
- The NZ ETS currently drives greater incentives for net reductions, which may be in tension with our domestic gross methane targets, however indicative modelling by MWLR suggests that even under current settings the NZ ETS option would achieve our gross domestic methane targets.
- There are trade-offs between lower acceptability of an NZ ETS solution to agriculture and improved perceptions of fairness and equity as viewed by other sectors from establishing parity in treatment between all sectors.
- The feasibility of implementing a farm-level NZ ETS solution in future is not clear.
- Free allocation would need to be carefully managed (such as adjusting levels of allocation over time) to avoid risks of overallocation and erosion of incentives to reduce emissions.
- There are opportunities for complementary measures, outside the NZ ETS, to address some of the broader political economy and acceptability concerns relating to the option that do not risk hindering the ability of the scheme to drive a robust price signal to the market.

Options 2 and 3: Pricing most agricultural emissions using a levy

The Partnership's farm-level split-gas levy (option 2)

We recommend two <u>essential</u> changes to the Partnership's proposal

25. Pricing emissions outside the NZ ETS through a levy does not align to our view of a first-best, whole-of-economy solution to drive net emissions reductions. A levy outside the NZ ETS would inherently split the market for emissions by pricing emissions from the agriculture sector separately to those from other sectors. This would constrain the economy-wide trade-offs necessary to support the most cost-effective approach to achieving our targets.

26. However, elements such as pricing at the farm-level for livestock and at the processor-level for fertiliser emissions reflect good principles of an economic solution by ensuring the price signal is perceived by those making decisions at the margin. This has the

benefit of improving the salience of the price signal and therefore supporting its use in decision-making by the sector.

27. The Commission has recommended pricing agricultural emissions using a levy, but highlighted concerns with the Partnership's proposal as currently tabled.[1] We share many of these concerns. Without addressing critical risks, we do not consider that the Partnership's proposal as tabled would be able to effectively price agricultural emissions in a manner aligned to sound economic principles. Given the criticality of effectively addressing agricultural emissions to meet our climate targets and supporting the Government's economic vision, we see our recommendations as essential.

28. **Risk: The Partnership have proposed including sequestration in a levy system beyond that eligible for the NZ ETS.** This approach would:

    a Misalign incentives with achieving our gross methane targets (by incentivising large amounts of relatively cheap sequestration which will not reduce gross emissions) and inhibit economy-wide trade-offs for sequestration. This risks undermining the ability of the NZ ETS to effectively reduce net emissions across the economy if sequestration ineligible to be counted against our targets is included in the proposed scheme.

    b Generate significant equity and credibility issues as other sectors would not be similarly rewarded for investment in this sequestration activity.

    c Add significant delivery and administrative complexity and cost for limited benefit.

    d Divert levy revenue from activities that better achieve our gross targets.

29. Instead, we strongly recommend **removing the sequestration scheme from the proposal and channelling sequestration via the NZ ETS**. In time, further vegetation categories could be added to the NZ ETS as scientific evidence of their emissions abatement potential improves. s9(2)(f)(iv)

30. **Risk: The system governance structure proposed is not sufficiently independent.** This approach would:

    a Inhibit the ability to objectively set levy prices, which could fundamentally undermine the ability of the system to apply an economically efficient price.

    b Increase the risk of regulatory capture from industry representation on the regulating entity's governing System Oversight Board.

    c Conflict with principles of good regulatory practice and governance, undermining the credibility of the system.

[1] Climate Change Commission (2022), *Progress Toward Agricultural Emissions Pricing*.

31. Instead, we strongly recommend **ensuring governance and levy-setting are independent and effective** by:

    a Removing industry representation from the governance board and fostering inclusion via a non-governing mechanism (e.g. using an advisory board or reference group).

    b Setting the levy in an economic manner (e.g. tethering levy prices to the NZ ETS carbon price as is currently done for the Synthetic Greenhouse Gas Levy or considering whether the Commission could have a role in recommending a levy price to Ministers in line with emissions budgets and economic models).

Other risks requiring important or desirable changes

32. We recommend the following adjustments to further enhance the Partnership's proposal and better align it with good economic principles.

33. **Risk: Splitting the pricing of gases across two pricing systems.** The proposed levy structure splits long-lives gases across the NZ ETS and levy. This would inhibit the ability to trade-off across sectors, potentially increasing the cost of our transition.

34. To partially address this issue, we recommend **excluding emissions from fertiliser from the long-life gas levy and pricing fertiliser at the producer-level through the NZ ETS**. This would:

    a Improve economic efficiency and the ability to apply economic trade-offs by increasing the coverage of 1) long-lived gases in the NZ ETS and 2) total emissions captured from fertiliser (as a farm-level levy will exclude fertiliser usage on some smaller farms).

    s9(2)(f)(iv)

    c Be feasible to implement quickly and at relatively low cost.

35. **Risk: An incentive structure highly reliant on 'incentive payments' to drive reductions**, which:

    a Increases the level of uncertainty in pricing outcomes (e.g. technology may not be available to drive the levels of gross abatement needed to meet targets, shifting the onus to other sectors and/or placing the achievement of our targets in jeopardy).

    b Reduces the fiscal sustainability of the scheme (e.g. in scenarios where demand for incentive payments exceeds revenue generated via the levy).

    c Risks double counting emissions reductions through both rewarding a reduction in the levy liability and abatement action through the incentive payment itself.

36. Instead, we recommend **readjusting the incentive structure** by pairing a strong marginal price with an appropriate set of complementary support mechanisms to avoid relying on incentive payments to drive abatement. Incentive payments could be considered on a targeted basis to address specific uptake barriers and smooth the impacts of transition rather than being a mainstay of the pricing system's incentive structure.

37. We think the strategy for the usage of levy revenue should **avoid hypothecation at a subsector level**. Highly granular hypothecation would inhibit trade-offs and the ability to fund large, cross-sector initiatives which would require the Crown to provide further funding. We also do not support the Partnership's proposed price ceiling for methane.

38. We understand under MWLR modelling this option achieves targets, primarily from sequestration-driven land use change reducing stocking levels in the sheep and beef subsector.

s9(2)(g)(i)

Starting at the processor-level and shifting to the farm-level in 2027 (option 3)

s9(2)(f)(iv)

40. Much of our advice pertaining to the Partnership's levy proposal holds true for this option. We understand preliminary modelling from MWLR suggests this option would meet our targets. We have limited our comments to key differences.

s9(2)(f)(iv)

In discussing a levy option at CRMG, we recommend that you note:

- The Treasury strongly recommends the following changes are made to the Partnership's proposal:
  - Removing the sequestration scheme from the proposal and channelling sequestration via the NZ ETS (**essential**).
  - Ensuring governance and levy-setting are independent and effective to set a sufficiently strong marginal price that incentivises the scale of change needed to meet our targets (**essential**).
- The Treasury also recommends the following changes are made:
  - Excluding emissions from fertiliser from the long-life gas levy and price fertiliser at the producer-level through the NZ ETS (**important**).
  - Readjusting the incentive structure by pairing a strong marginal price with an appropriate set of complementary support mechanisms (such as free allocation or a rebate tied to output) (**important**).
  - Avoiding hypothecating levy revenue at a subsector (or more granular) level to avoid sub-optimal investment (**desirable**).

s9(2)(f)(iv)

Implementation considerations focussing on levy options

The Commission's recent report into progress highlighted delivery risks

42. As advised previously, there is considerable delivery risk and complexity in implementing options outside of the NZ ETS by 1 January 2025 [T2022/1304 and T2022/1288 refer]. Reflecting this, we have focussed our analysis on levy options.

43. In its June report on progress towards agricultural emissions pricing, the Commission:[2]
    a Highlighted the delivery risk of the Partnership's proposal, concluding with *high confidence* that the pricing system as written would not be practical to implement by 1 January 2025. It also determined with significant effort a streamlined version of the Partnership's proposal could be implemented by 1 January 2025.
    b Identified with *low confidence* that the commitment for 100% of farms having a written plan in place to measure and manage their emissions by 1 January 2025 will be met on time.

44. The Commission was not able to assess the delivery readiness of the Crown in reaching these conclusions due to a lack of available evidence.

45. The Commission's recommendations for a farm-level streamlined levy in 2025 would still require: registering a significant number of farms; passing legislation and drafting regulations; designing, building, and administering ICT and data management systems; establishing and administering a compliance function; and developing and

[2] Climate Change Commission (2022), *Progress Toward Agricultural Emissions Pricing*.

delivering enforcement mechanisms. We remain of the view that the scale of change required, s9(2)(g)(i) s9(2)(g)(i) and market constraints in the ICT sector will be significant hurdles to overcome.

Opportunities to influence implementation planning now

46. There are implementation choices you can influence now to help mitigate delivery risk:

s9(2)(f)(iv)

[redacted]

[3] Climate Change Commission (2022), *Advice on Agricultural Assistance*.

s9(2)(f)(iv)

Facilitating a smooth transition for the sector

Targeted assistance may improve the acceptability of the system

52. We recognise that the agriculture sector is trade exposed and many of its international competitor markets may not face similar domestic emissions pricing policies. It is important that the transition is well-paced and supports economic resilience and security. The Government has also previously committed to a just and equitable transition. Pricing the sector's emissions may have social and financial impacts, result in changes to employment, and impacts to the sector's production. For example, the sheep and beef subsector is more sensitive to land use change than dairy[4] and forestry offers lower average employment than sheep and beef per hectare. The sector has also been subject to recent regulatory changes (e.g. freshwater reforms).

53. Recognising this, the Government funded initiatives totalling over $463 million through Budget 2022 to support the sector. Beyond these initiatives, targeted assistance can help smooth transition impacts, support trade competitiveness, and reduce risks of emissions leakage where they are seen as material. The Commission highlighted the potential appropriateness of assistance in its May advice.[5] However, in this advice, the Commission concluded that the risk of emissions leakage is highly uncertain but appears to be low for agriculture in New Zealand in the near term. We support the Commission's view that *"any decision to provide assistance <u>on the grounds of</u>*

[4] Interim Climate Change Committee (2019), *Technical appendix 6: Distributional impacts of agricultural climate change policy*.
[5] Climate Change Commission (2022), *Advice on Agricultural Assistance*.

<u>emissions leakage alone</u> should be based on sound evidence about the materiality of emissions leakage risk and applied to individual agricultural activities."[6]

s9(2)(f)(iv)

In discussing the transition for the sector at the CRMG, we recommend that you note:

- The role of targeted assistance in facilitating a just and equitable transition.

s9(2)(f)(iv)

Next steps on decisions

56. We aim to provide you a briefing ahead of Cabinet's September decision on policy options for public consultation. This advice will focus on further analysis of preferred option(s) progressed by Ministers, considerations for public consultation, and implementation. Our future advice will also canvass how pricing option(s) contribute to the Government's broader economic strategic framework.

57. Following public consultation on pricing options, we will provide advice ahead of the release of the public report in December and final policy decisions, which are expected to be taken to Cabinet in February 2023.

58. **Annex 4** provides a high-level timeline of our proposed advice.

[6] Ibid.
[7] Ibid.

Annex 1: Overview of policy options as currently tabled

Option <u>as currently written</u>	Option 1: **Processor-level NZ ETS backstop**	Option 2: **Farm-level split-gas levy from 2025**	Option 3: **Processor-level levy from 2025 and farm-level in 2027** *Described below at processor-level*
Underlying economic instrument	System akin to 'cap and trade'	Levy	Levy
Point of obligation	Meat and dairy processors Fertiliser manufactures and importers (~80 processors in total)	Individual farms or collectives over 200t CO_2 eq- per annum (approximately 23,000 farms, although the exact number is not known)	Meat and dairy processors Fertiliser manufactures and importers (~80 processors in total)
Basis for calculating emissions	Emissions = output × emissions factor	Centralised calculator to determine farms' emissions (simple and complex calculators are proposed)	Emissions = output × emissions factor
Emissions price	One price, with costs of surrender obligations based on emissions factors to convert all greenhouse gases into CO_2 eq- emissions	Two prices (for short- and long-lived gases), initially set around 5% of the NZU price (proposed at 11c/kg of emissions)	Two prices (for short- and long-lived gases), initially set around 5% of the NZU price (proposed at 11c/kg of emissions)
Emissions volume priced	5% of emissions initially, increasing at 1% p/a (based on an initial 95% free allocation level on an output basis)	100% of emissions	100% of emissions
Price setting	Price set by the NZ ETS market	Levy prices to be set by Ministers on advice from a System Oversight Board (with industry representation)	Levy prices to be set by Ministers on advice from industry
Eligible sequestration and sequestration pricing	NZ ETS eligible forests only	NZ ETS eligible forests <u>and</u> non-eligible sequestration discounted between 75-90% of the NZU price	NZ ETS eligible forests (at farm level) <u>and</u> non-eligible sequestration through Sequestration Management Contracts (**SMC**)
Payments for approved action	-	"Incentive discount" for approved mitigation actions	Payments to farmers for approved actions through Emissions Management Contracts (**EMC**)
Revenue recycling	Government has indicated a commitment to hypothecation	All revenue to be recycled into pricing system and sector. Revenue to pay for incentive discounts and sequestration	All revenue to be recycled into pricing system and sector. Revenue used to pay for EMCs and SMCs

Annex 2: Principles of a robust and enduring pricing system

Principles	**An ECONOMIC solution**	**An ACCEPTABLE solution**	**A FEASIBLE solution**
	Takes an economic approach to drive efficient solutions	*Gives effect to Treaty obligations, political economy and equity considerations*	*Is achievable and affordable, within an acceptable risk profile*
Sub-principles	**Economically efficient** • The price fully internalises the externality. • The price is incurred by the party who generates the externality. • The price signal is effectively perceived and applied by those who are making the behaviour/investment decision. • Incentivises a least-cost approach to abatement. • Enables economy wide trade-offs between or within sectors. **Complementary measures leverage the pricing system** • Any additional measures are designed to complement, rather than substitute or hinder, the core price signal. • Complementary measures are grounded in robust intervention logic, such as addressing additional market failures.	**Upholds Te Tiriti o Waitangi** • Supports the Crown's Treaty of Waitangi obligations, and does not compound existing or historical grievances for Māori/Iwi. **Distributionally fair** • Pursues distributional fairness across sectors, regions, and time. • Considers flow-on impacts to the economy, trade, and production. **Supported** • Balances support from the agriculture sector with that from other sectors. **Congruent and aligned** • Is congruent with the existing policy landscape, relevant government objectives, and strategies. • Incentivises co-benefits. • Mitigates emissions leakage risk. **Credible** • Grounded in robust scientific and economic evidence. • Transparent in its approach.	**Practical to deliver and administer** • Represents a reasonable delivery timeframe, implementation risk profile, and cost. • Results in reasonable ongoing administration/compliance complexity and costs for Government/Industry. • Integrates, where possible, with existing processes/makes use of existing capabilities. **Adaptable to change** • Retains flexibility/adaptability to changes in technology and policy settings to avoid lock-in without compromising certainty for investment decisions. **Fiscally sound** • Retains sufficient optionality over the usage of levy revenue. • Minimises fiscal risk to the Crown (including ongoing requirement to inject further funding into agriculture emissions reductions once the system is established).

Annex 3: Assessment of policy options as tabled against our principles

Options as tabled	Principle 1: **An economic solution**	Principle 2: **An acceptable solution**	Principle 3: **A feasible solution**
Option 1: ***NZ ETS Backstop***	+ More confidence this option would generate an economic price through a market mechanism. + Enables a least cost approach and trade-offs across the economy. ± While the price would not be incurred by those who generate the externality, we expect processors would pass through costs to farmers. ± Based on current relative abatement costs, anticipated to drive greater net, rather than gross, emissions reductions. This has mixed implications for our net and gross targets (***NB:*** *MWLR modelling suggests overachievement of targets under this option even under low carbon price scenarios due the gross emissions reductions achieved through land-use change*).	+ Volatility in unit prices could be controlled by NZ ETS mechanisms (e.g. cost containment trigger). + Consistent with treatment of other sectors and the treatment of methane from the waste and agriculture sectors. + The cap is set in alignment to emissions budgets. ± Free allocation can mitigate financial impacts of a high price (similar for other trade exposed sectors) but may risk overallocation, diluting the price signal. – Least supported option by the agriculture sector. – Does not explicitly reward on-farm action to reduce emissions.	+ Lowest implementation risk and cost of the options. + Compliance requirements expected to be proportionate and reasonable for processors. + Flexible means of managing revenue, with revenue hypothecated as part of other NZ ETS revenue. – Retains option to shift to farm-level later but there are feasibility challenges with farm-level capabilities to manage NZ ETS interfaces. – NZ ETS is complex and so any future changes to the system would need to carefully consider the integrated flow-on impacts.
Option 2: ***Farm-level split gas levy (Partnership proposal)***	+ The price would be incurred directly by those who generate the externality. ± Pricing methane separately allows for greater focus on achieving gross methane reduction targets. However, a split-gas pricing approach has negative implications for supporting important whole-of-economy trade-	+ This is the most widely supported option by the agriculture sector, including Māori/Iwi. – If the levy does not generate a strong price signal, there may be distributional issues from shifting the onus (and costs) for meeting our targets to other sectors and increasing New Zealand's overall costs of transition.	– Highest implementation risk and cost of the options (even for a simple farm-level levy). s9(2)(g)(i)

Options as tabled	Principle 1: **An economic solution**	Principle 2: **An acceptable solution**	Principle 3: **A feasible solution**
	offs across greenhouse gases to occur that are necessary to achieve our net emissions reduction targets. – Mechanism for setting the levy is not independent and there is a material risk of the price being set lower than the economically efficient level. – Sequestration proposal undermines the NZ ETS sequestration scheme and would create a barrier to economy-wide trade-offs of long-lived gas removals necessary to cost-effectively achieve our net emissions reductions targets.	– The proposed System Oversight Board (with industry representation) may pose regulatory capture risk. – The sequestration scheme incurs equity issues as farmers would be able to receive payment for sequestration not available to other landowners. – There is limited scientific evidence for rewarding some of the sequestration proposed and some cannot count towards our targets.	– Risk of industry seeking to fragment the funding landscape into subsector funds if hypothecated for the sector – Low levy prices may create a fiscal sustainability risk for the scheme given the potential demand for incentive payouts and sequestration, necessitating further Crown funding. – Fiscal risk if we do not achieve our NDCs.
Option 3: ***Processor-level hybrid levy in 2025 to farm-level levy in 2027***	Similar considerations to Option 2 and: – Initial pricing at the processor level would mean the emissions cost would not be directly incurred by those who generate the externality until such time that a farm-level levy is instituted. – Proposed levy prices are low and unlikely to drive meaningful emissions reductions; reductions through this option are dependent on complementary incentives such EMCs and SMCs.	– As for option 2, with the exception that there was less support for this option by the agriculture sector.	± Lower delivery risk and lower cost than a farm-level option but potential for duplicated cost and effort for Crown and the industry in transitioning between systems.

Annex 4: Next steps for Treasury advice

Milestones (per lead agency plans)	**Formal decisions required by you**	**Our planned advice**
July 2022 • Independent modelling report from Manaaki Whenua Landcare Research on the policy options.		July: A Treasury Report outlining our view of policy options (**this advice**).
September 2022 • Cabinet makes policy decision for public consultation. • s9(2)(f)(iv)	Decision by Cabinet on the preferred policy option for public consultation s9(2)(f)(iv)	A briefing on the preferred policy option, s9(2)(f)(iv)
October – November 2022 • Public consultation • Development of final policy advice.	None.	Briefing(s) as required.
December 2022 • Government published report on agricultural emissions pricing. s9(2)(f)(iv)	s9(2)(f)(iv)	Advice on s9(2)(f)(iv) and public report.
February 2023 • Cabinet makes final policy decision.	Decision by Cabinet on the preferred policy option for public consultation.	A Treasury Report on the preferred policy option.

TE TAI ŌHANGA
THE TREASURY

Treasury Report: Briefing for 16 August Meeting of the Climate Response Ministers Group

Date:	11 August 2022	**Report No:**	T2022/1755
		File Number:	SH-10-8

Action sought

	Action sought	Deadline
Hon Grant Robertson **Minister of Finance** Hon Kiri Allan **Associate Minister of Finance**	**Note** advice from Treasury for your participation in the Climate Response Minsters Group meeting on 16 August.	16 August 2022

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
Tom Wilson	Senior Analyst, Climate Change	s9(2)(k)	n/a (mob)	✓
Nicky Lynch	Manager, Climate Change		s9(2)(g)(ii)	

Minister's Office actions (if required)

Return the signed report to Treasury.

Refer this report to the Minister Responsible for the Earthquake Commission.

Note any feedback on the quality of the report	

Enclosure: No

Treasury Report: Briefing for 16 August Meeting of the Climate Response Ministers Group

Executive Summary

There are two items on the Climate Response Ministers Group (CRMG) meeting agenda: managed retreat and adaptation responses, and He Waka Eke Noa.

Agenda Item 1. Managed retreat and adaptation responses

s9(2)(f)(iv)

Agenda Item 2. He Waka Eke Noa

A methane quota system (MQS) may be discussed as a further option for agricultural emissions pricing. While an MQS applies a market derived price and prices agricultural nitrous oxide via the New Zealand Emissions Trading Scheme, we do not recommend supporting the advancement of this option to public consultation.

s9(2)(f)(iv)

s9(2)(f)(iv) This option also carries additional implementation risk in tabling an entirely new option that industry and Government have not considered in detail.

Recommended Action

We recommend that you:

a **Note** the recommended talking points provided in Appendix 1 of this document.

b **Refer** this report to the Minister Responsible for the Earthquake Commission.

Referred / not referred

Nicky Lynch
Manager, Climate Change

_____/_____/_____

Hon Grant Robertson
Minister of Finance

_____/_____/_____

Hon Kiri Allan
Associate Minister of Finance

_____/_____/_____

Treasury Report: Briefing for 16 August Meeting of the Climate Response Ministers Group

Purpose of Report

1. The Climate Response Ministers Group (CRMG) is meeting on Tuesday 16 August. The agenda will cover two items:
   - Managed retreat and adaptation responses.
   - He Waka Eke Noa.
2. We have not received the final CRMG agenda, but we do not anticipate that the final agenda will alter the views expressed in this report.

Item 1: Managed retreat and adaptation responses (Minister of Climate Change)

s9(2)(f)(iv)

s9(2)(f)(iv)

s9(2)(f)(iv)

s9(2)(f)(iv)

s9(2)(f)(iv)

s9(2)(f)(iv)

Item 2: He Waka Eke Noa (Minister for Climate Change)

29. Talking points are provided in Appendix 1.

30. We understand that the Minister for Climate Change may raise a Methane Quota System (MQS) as an option for pricing agricultural emissions, additional to options discussed at the July 29 CRMG meeting. We have not received a detailed proposal on the MQS and therefore our advice is preliminary.

31. A MQS would establish an annual capped quota for methane emissions units. Eligible farmers would acquire their quota (for instance through an auction) and trade these on a secondary market. Agricultural long-lived gas emissions would be priced through the NZ ETS. There would be no fungibility for the methane quota units with the NZ ETS market for long-lived gases or forestry offsets.

32. As advised previously [T2022/1303 refers], the Treasury's recommended first-best approach to pricing agricultural emissions is to include the agriculture sector within the NZ ETS where efficient whole-of-economy trade-offs can be made. We note that this option would effectively create a cap on methane emissions as they would be within the overall cap on emissions provided by the NZ ETS. This approach would not specify the mix of emissions allowed from different gases, but our view is that this is preferable to support whole of economy trade-offs.

33. s9(2)(f)(iv) [redacted]

34. At this stage in the policy development process, we view the pursuit of an additional option to those agreed previously as carrying significant additional implementation risk, particularly for a farm-level solution. An MQS has not been closely considered by the Government or by the sector to date and its inclusion now risks diverting resource and focus away from developing already tabled pricing options.

35. s9(2)(f)(iv) [redacted]

36. If Ministers wish to progress this option, we will provide further advice at that point.

Appendix 1. Suggested talking points:

Item 1. Managed Retreat and Adaptation Responses

Recommendation to CRMG	Suggested talking points
s9(2)(f)(iv)	

s9(2)(f)(iv)

Item 2. He Waka Eke Noa

You may wish to:

s9(2)(f)(iv)

Note the importance of pricing agricultural emissions as soon as is practicable and that the inclusion of an additional option now creates significant implementation risk, beyond the implementation risks already faced by the options currently on the table.

Recommend not advancing the MQS option further.

From: Luke Crossen [TSY]
Sent: Monday, 15 August 2022 3:59 PM
To: ^parliament: Udayan Mukherjee
Cc: Tom Wilson [TSY]; Nicky Lynch [TSY]; James Haughton [TSY]; Melanie Craxton [TSY]; Davin Hall [TSY]; Guy Bennett-Longley [TSY]; Vicki Plater [TSY]; James Beard [TSY]; Alexis Belton [TSY]; Wendy Sowden [TSY]
Subject: RE: Supplementary advice on agricultural emissions pricing to support August 16 CRMG

[ ]

Thanks Udayan,

Only points I would add relate to modelling results, which we anticipate may get a bit of focus in the discussion. As far as we can tell, the final paper has not changed from the draft agency Ministerial briefing paper we based our Friday advice on.

- MPI commissioned modelling from Manaaki Whenua Landcare Research Limited (MWLR) and has received draft modelling results – these are outlined in **Appendix One** of the CRMG paper supporting agenda item 2. These results have not been peer reviewed.
- The indicative modelling shows some **reasonably large structural changes** to the mix of land use types across all policy options modelled, even with free allocation provided at 95% declining 1% per annum.
- We recommend you highlight to the CRMG that:
    - **The differences in land use change, production, and revenue impacts observed across policy options may partly be a function of the differences in underlying pricing inputs used for these options.** For instance, a higher emissions price was modelled for the NZ ETS policy option relative to the farm-level split-gas levy options. Our view is that if equivalent price level inputs were used policy scenarios would produce more similar outcomes.
    - **Impacts across all policy options were high for the red meat subsectors and dairy, to a lesser extent**. The red meat farms modelled have lower net profit per unit of output, higher emissions intensity per unit of output, and fewer mitigation options available than other land use classes, such as dairy and horticultural uses.
    - **A degree of structural change is expected from implementing emissions pricing** given the historic lack of incentives and the implicit subsidy that the sector has experienced to date. In addition, there may be a number of farms that, when facing the full cost of their production, may no longer be viable.
    - **It is important that structural transition is appropriately paced to support the Government's economic vision and uphold the its commitment to a just and equitable transition**.
    - **An output-based approach to free allocation (or rebate) would help mitigate impacts by incentivising the sector to maintain high levels of production.** This option was recommended by the Climate Change Commission and we recommend it be included in public consultation. While lead agencies have identified feasibility challenges with an output-based approach to free allocation (e.g. with defining 'output' in the context of the red meat subsector), we consider further work should be undertaken by lead agencies given this method also supports the generation of a marginal price signal.
- We consider **pricing agricultural emissions to be of vital importance for meeting our domestic and international targets** and for supporting transition to a lower emissions economy. However, there is a trade-off with the speed of transition and the desire to ensure it is appropriately paced to mitigate impacts. We

will provide you further advice on transition impacts and pathways to support Ministerial consultation in early September.

Ngā mihi,
Luke

Luke Crossen | Senior Analyst, Natural Resources
Te Tai Ōhanga – The Treasury
T: +s9(2)(k) E: luke.crossen@treasury.govt.nz

From: Udayan Mukherjee <Udayan.Mukherjee@parliament.govt.nz>
Sent: Monday, 15 August 2022 12:51 pm
To: Luke Crossen [TSY] <Luke.Crossen@treasury.govt.nz>
Cc: Tom Wilson [TSY] <Tom.Wilson@treasury.govt.nz>; Nicky Lynch [TSY] <Nicky.Lynch@treasury.govt.nz>; James Haughton [TSY] <James.Haughton@treasury.govt.nz>; Melanie Craxton [TSY] <Melanie.Craxton@treasury.govt.nz>; Davin Hall [TSY] <Davin.Hall@treasury.govt.nz>; Guy Bennett-Longley [TSY] <Guy.Bennett-Longley@treasury.govt.nz>
Subject: RE: Supplementary advice on agricultural emissions pricing to support August 16 CRMG

Thanks Luke – literally just now the attached paper has come through formally to Ministers' offices.

Will provide to MoF overnight, but do let me know if there is anything additional you might want to say beyond your notes below, having reviewed this final version of the paper.

From: Luke Crossen [TSY] [mailto:Luke.Crossen@treasury.govt.nz]
Sent: Monday, 15 August 2022 12:32 PM
To: Udayan Mukherjee <Udayan.Mukherjee@parliament.govt.nz>
Cc: Tom Wilson [TSY] <Tom.Wilson@treasury.govt.nz>; Nicky Lynch [TSY] <Nicky.Lynch@treasury.govt.nz>; James Haughton [TSY] <James.Haughton@treasury.govt.nz>; Melanie Craxton [TSY] <Melanie.Craxton@treasury.govt.nz>; Davin Hall [TSY] <Davin.Hall@treasury.govt.nz>; Guy Bennett-Longley [TSY] <Guy.Bennett-Longley@treasury.govt.nz>
Subject: RE: Supplementary advice on agricultural emissions pricing to support August 16 CRMG

Hi Udayan,

Thanks for reaching out.

We have not received any further documentation on CRMG beyond what was forwarded to us by Laura last week.

Will send anything through that we receive.

Ngā mihi,
Luke

Luke Crossen | Senior Analyst, Natural Resources
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From: Udayan Mukherjee <Udayan.Mukherjee@parliament.govt.nz>
Sent: Monday, 15 August 2022 12:27 pm
To: Luke Crossen [TSY] <Luke.Crossen@treasury.govt.nz>
Cc: Tom Wilson [TSY] <Tom.Wilson@treasury.govt.nz>; Nicky Lynch [TSY] <Nicky.Lynch@treasury.govt.nz>; James

Haughton [TSY] <James.Haughton@treasury.govt.nz>; Melanie Craxton [TSY] <Melanie.Craxton@treasury.govt.nz>; Davin Hall [TSY] <Davin.Hall@treasury.govt.nz>; Guy Bennett-Longley [TSY] <Guy.Bennett-Longley@treasury.govt.nz>
Subject: RE: Supplementary advice on agricultural emissions pricing to support August 16 CRMG

Hi Luke (and others),

You may have heard that Laura is off unwell today, so I am picking up to make sure MoF gets all the relevant papers for CRMG tomorrow.

Your briefing notes below have made its way to MoF over the weekend with the rest of the pack. It'd be great if you could let me know if there has been any further finalised material for tomorrow on HWEN that has come through to you. (Laura & Toby were also following up with Minister Shaw & O'Connor offices on this point.)

No worries if this is a nil response – just wanting to check.

Thanks,
Uday

Udayan Mukherjee | **Economic Advisor**
Office of Hon Grant Robertson
Minister of Finance
Level 7.6 Executive Wing, Parliament Buildings, PO Box 18041, Wellington 6160, New Zealand
M: s9(2)(g)(ii)
E: udayan.mukherjee@parliament.govt.nz

From: Luke Crossen [TSY] [mailto:Luke.Crossen@treasury.govt.nz]
Sent: Friday, 12 August 2022 3:51 PM
To: Laura Berntsen <Laura.Berntsen@parliament.govt.nz>
Cc: Guy Bennett-Longley [TSY] <Guy.Bennett-Longley@treasury.govt.nz>; Vicki Plater [TSY] <Vicki.Plater@treasury.govt.nz>; Davin Hall [TSY] <Davin.Hall@treasury.govt.nz>; James Haughton [TSY] <James.Haughton@treasury.govt.nz>; Melanie Craxton [TSY] <Melanie.Craxton@treasury.govt.nz>; Nicky Lynch [TSY] <Nicky.Lynch@treasury.govt.nz>; James Beard [TSY] <James.Beard@treasury.govt.nz>
Subject: Supplementary advice on agricultural emissions pricing to support August 16 CRMG

[ ]

Hi Laura,

Please see below the supplementary bullet points to support the finalised agenda for CRMG on 16 August:

An overall point we have is we see benefit in consulting on a sufficiently broad range of policy design choices, evening if these may not be the preferred option. This theme is reflected in a number of points below.

- ***Policy issue one – Point of obligation:*** Lead agencies have proposed removing the option to price fertiliser at the processor level from public consultation. Treasury does not support this proposal and recommend it be retained as an option for public consultation. Pricing fertiliser at the processor-level will better enable a pricing system to apply trade-offs across the economy for long-lived gases. We also think that fertiliser processors have greater influence over emissions-reducing actions pertaining to fertiliser than farmers as processors have direct control over the formulation of their products (and therefore their respective emissions intensity). These views were supported by the Climate Change Commission.
- ***Policy issue two – Setting a levy rate*****:** Lead agencies have proposed consulting on options to tether the long-lived gas levy to the NZ ETS unit price and not to include a proposal for the starting methane price in the consultation document and, instead, carry out more work on a range of methane prices. Treasury

supports consulting on a broad range of options for setting levy prices, including options to tether long-lived gas levy price to the NZ ETS or based on robust economic modelling from the Climate Change Commission. We also agree further analysis is needed to determine the optimal approach to setting a methane levy. Overall, we still would prefer all abatement supply and demand in one market where the price was discovered and set accordingly to enable whole-of-economy trade-offs.

- ***Policy issue three – Feasibility of output-based assistance:*** Lead agencies believe that an output-based approach to assistance is infeasible and have proposed to provide a proxy for a high marginal price incentive by rewarding farmers at a rate higher than the levy rate for emissions reduction from technologies adopted or mitigation actions taken. However, given the potential benefits for supporting the generation of a full marginal price and incentivising maintaining sector production levels, Treasury considers that implementation of an output-based approach to free allocation warrants further investigation regarding its feasibility for implementation by 1 January 2025 and should be retained for public consultation. We also note that rewarding mitigation actions at rates higher than the prescribed levy may risk the overall financial sustainability of the scheme, which should be funded from recycled levy revenue.

s9(2)(f)(iv)

- ***Policy issue five – Compliance and oversight:*** We are supportive of lead agency officials views that governance should not have representatives from the agricultural sector represented as that would not support good regulatory practice and may generate a conflict of interest.

It is worth caveating this advice that it is preliminary, noting we only received the associated briefing from lead agencies yesterday evening and learnt that this was on the agenda for CRMG at midday today. We will be providing more substantive advice to lead agencies directly through agency consultation next week and to the Minister through Ministerial consultation, which we had been advised would likely commence in late August / early September.

Any questions, please let me know.

Ngā mihi,
Luke

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TE TAI ŌHANGA
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Please note that I am based in Christchurch

TE TAI ŌHANGA
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Treasury Report: Agricultural Emissions Pricing: Treasury Advice ahead of Ministerial Consultation

Date:	14 September 2022	**Report No:**	T2022/1789
		File Number:	AC-4-5-21

Action sought

	Action sought	Deadline
Hon Grant Robertson **Minister of Finance**	**Note** the contents of this report **Agree** the recommendations of this report **Refer** this report to the agreed Ministers **Discuss** the content of this report with the agreed Ministers **Indicate** if you wish to discuss with officials	23 September 2022

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
Guy Bennett-Longley	Analyst, Natural Resources	s9(2)(k)	N/A (mob)	✓
Luke Crossen	Senior Analyst, Natural Resources		N/A (mob)	
James Haughton	Manager, Natural Resources		Yes (mob)	

Minister's Office actions (if required)

Return the signed report to Treasury.

Refer this report to the agreed Ministers.

Note any feedback on the quality of the report

Enclosure: No

Treasury Report: Agricultural Emissions Pricing: Treasury Advice ahead of Ministerial Consultation

Executive Summary

Pricing agricultural emissions is vital for achieving the Government's economic vision

We consider agricultural emissions pricing to be a fundamental step to achieving the Government's economic vision of a high wage, low emissions economy that supports economic security in good times and bad. Pricing agricultural emissions is essential to achieve our legislated domestic and international climate targets, and will better balance the costs of transition across the economy.

You have a Cabinet meeting on 3 October where decisions will be taken on public consultation for pricing options. This is a critical opportunity to influence the direction of policy design. This report provides you with advice on a methane quota system (**MQS**), the current levy proposal, implementation considerations, and transitional pathways for the agriculture sector.

This advice is based on preliminary documentation received from agencies and therefore details of the policy proposals remain subject to change.

We do not recommend progressing a methane quota system at this time

CRMG Ministers have indicated that a farm-level levy system is the preferred option for consultation, with a transitional processor-level levy system as a back-up. These options will be compared to the New Zealand Emissions Trading Scheme (**NZ ETS**) backstop – the Treasury's preferred option. However, we understand that a MQS has been raised as a further option.

While an MQS has some merit, we do not recommend advancing it to public consultation. An MQS would have considerable feasibility risks and further investigating this option would increase the likelihood of material delays to establishing an agricultural emissions price. Considering these risks, we do not consider that an MQS is likely to deliver material advantages over a levy. If Ministers wish to implement a quantity-based pricing instrument, our advice is to use the already-established NZ ETS.

The levy proposal should be enhanced further, and optionality should be retained

It is critical that agricultural emissions are priced so that these costs can inform decision-making by the sector and drive emissions reductions. We see significant value in developing a simplified initial approach that is both durable and flexible so that it can be built on and enhanced over time.

Lead agencies have proposed an approach that includes:

- a long-lived gas levy tethered to the NZ ETS unit price with a proportional discount,
- a methane levy set relative to the agriculture sector's performance against gross methane targets, and
- incentive payments for undertaking mitigation actions.

Lead agencies have also considered options for rewarding additional sequestration via the NZ ETS or within a levy system.

We are concerned that by applying a high proportional discount across long-lived gas emissions and setting the levy price for methane at the lowest level needed to achieve gross targets, the levy price will be too low to achieve our long-term targets. While a low levy price is one way to assist the industry to transition initially, it is unlikely to fully reflect the emissions externality. We also think agencies may be narrowing detailed policy choices on financial assistance too soon.

To address these concerns, we think the consultation paper should:

1) **Explore setting the methane levy either by tethering it to the NZ ETS or on independent advice from the Climate Change Commission** to preserve efficient trade-offs across the economy and the ability to apply an adaptive management approach to achieving our NDC and emissions budgets. If the Commission is tasked with this, we suggest it consider factors beyond progress of methane targets.

2) **Include an output-based form of financial assistance as an option while lead agencies undertake further options analysis on the optimal form of financial assistance.** Lead agencies' preferred option of combining low levy prices with incentive payments is inconsistent with our recommended approach relying primarily on emissions pricing to incentive abatement. We consider that there is merit in consulting on alternative levy designs, including combining salient prices with output-based financial assistance to manage adverse transitional impacts as recommended by the Commission in its advice.

   If it is not possible to implement method(s) of assistance that preserve strong incentives by 2025, then we acknowledge that it may be necessary to start with lower levy prices to avoid widespread financial hardship. However, to achieve New Zealand's long-term climate targets and ambitions, an improvement to this approach would be needed.

3) **De-couple investigation of additional forms of sequestration from the agricultural pricing work programme.** Making the implementation of the core pricing policy contingent on operationalising additional sequestration categories substantially increases the risk and complexity for the overall programme. In our view any additional vegetation that delivers genuine sequestration benefits able to be counted towards our targets should be channelled via the NZ ETS.

4) **Pursue cost-neutrality of the scheme as a design objective.**

Implementing the pricing policy will require deliberate management and prioritisation

s9(2)(f)(iv)

Structural change aligns to your economic vision and you have choices over its pace

We expect that material structural change in the primary sector will result from implementing emissions pricing, given the historic lack of incentives addressing the sector's emissions and the implicit subsidy that agriculture has received to date. Structural shifts can help realise opportunities and stimulate private sector innovation. The ability to adjust through land use change is a strength of our primary sector.

However, it is important that structural change is signalled well in advance and appropriately paced – a sharp, disruptive transition will detract from economic resilience. There will be a tension to manage between near-term economic security (e.g., supporting food security and trade) and the scale and pace of the change needed by the sector to deliver on our climate targets. Results from preliminary modelling predict rapid structural change to achieve the 2030 targets, particularly for red meat subsectors. While likely directionally correct, further testing and refinement of modelling results is being progressed by lead agencies.

The Government has control over policy levers that can help accelerate or slow transition. Levers include s9(2)(f)(iv) and the provision of financial assistance. Our recommendations on the provision of financial assistance seek to complement, rather than hinder or substitute, the core price signal.

Recommended Action

We recommend that you:

a **note** this advice is based on preliminary documents and proposals are subject to change,

b **note** the Treasury's previous advice that the NZ ETS is the Treasury's preferred option for pricing the agriculture sector's emissions,

c **note** that we do not recommend a methane quota system be advanced further due to feasibility risks, risk to delaying instituting an emissions price, and that the NZ ETS would be the preferable pathway for implementing a quantity-based instrument,

d **note** that we have focussed our advice on how the current farm-level levy could be improved (given Ministers' preference for a farm-level levy) and have identified the following recommendations:

1) Explore setting the methane levy either by tethering it to the NZ ETS or on independent advice from the Climate Change Commission. If the Commission is tasked with this, we suggest it consider factors beyond progress of methane targets,

2) Include an output-based form of financial assistance as an option while lead agencies undertake further options analysis on the optimal form of financial assistance,

3) De-couple investigation of additional forms of sequestration from the agricultural pricing work programme, and

4) Pursue cost-neutrality of the scheme as a design objective.

e **agree** that these recommendations be reflected in the public consultation document.

Agree/Disagree.

f **note** our preference remains that long-lived gas fertiliser emissions are priced at the processor level via the NZ ETS and public consultation include this as an option for discussion,

s9(2)(f)(iv)

j **note** that preliminary modelling predicts rapid land use change from pricing, but that further refinement of modelling is expected,

k **note** that structural change is likely to result from implementing pricing, and this could be supported by appropriate forms of financial assistance,

l **refer** this report to the:

Prime Minister	Associate Ministers of Finance	Minister of Agriculture	Minister of Climate Change
Refer/not referred.	*Refer/not referred.*	*Refer/not referred.*	*Refer/not referred.*

m **discuss** the recommendations contained in this report with the Ministers of Climate Change and Agriculture:

Agree/Disagree.

n **indicate** whether you would like to discuss this report with Treasury officials.

Yes/No.

James Haughton
Manager, Natural Resources

Grant Robertson
Minister of Finance

_____/_____/_____

Treasury Report: He Waka Eke Noa: Treasury Advice on Public Consultation

Purpose of the report

1. Decisions on public consultation for agricultural emissions pricing options are due to be considered by Cabinet on 3 October 2022. This report responds to a request for further advice from the Treasury on a methane quota system (**MQS**). It also outlines our advice on the current levy proposal, implementation considerations, and transitional pathways for the agriculture sector that align with the Government's economic vision.

2. Due to the rapid pace of policy development, we have had to base this report on preliminary documents. As such, elements of the proposals we reference may adjust. We are providing you this report now to support your ability to influence the direction of travel ahead of what we expect to be a truncated Ministerial consultation period. We may provide you with a further briefing, particularly if proposals evolve in coming weeks.

Background

Pricing agricultural emissions is of vital importance to your economic vision

3. The Government's economic vision of a high wage, low emissions economy that supports economic security in good times and bad will require structural change across the economy, including the agriculture sector [T2022/1342 refers]. Strong, coherent, and effective incentives for driving this change will be needed and an emissions pricing policy grounded in sound economics will help enable this.

4. Agriculture currently accounts for 50% of New Zealand's gross emissions and over 90% of our methane emissions – but these emissions are currently unpriced. The absence of pricing shifts the onus (and cost) onto private households and other sectors of the economy to meet our domestic and international climate targets, distorting the efficient allocation of costs. As such, we consider pricing agricultural emissions to be of vital importance and any delay to a pricing policy therefore carries significant cost.

This is an important point for influencing the direction of pricing policy

5. We previously provided you advice that the **New Zealand Emissions Trading Scheme (NZ ETS) backstop** is Treasury's first-best option for pricing the agriculture sector's emissions [T2022/1303 refers]. The NZ ETS remains our preferred option.

6. Ministers have since indicated that a **farm-level system is the preferred option** for consultation, with a transitional **processor-level levy system as a back-up** should key implementation milestones be missed. Ministers also agreed that public consultation would compare these options to the legislated NZ ETS backstop.

7. We also understand that an MQS is being discussed. We have previously advised that we do not support advancement of an MQS at this time [T2022/1755 refers].

8. Pending Ministerial agreement, decisions on public consultation are anticipated in early October. The Government must release a report by the end of 2022 under section 215 of the Climate Change Response Act 2002 outlining how agricultural emissions will be priced. Decisions on consultation will set the course for final policy decisions. We understand from lead agencies that detailed proposals to inform direction for legislative drafting will be taken to Cabinet in February 2023.

Section 1: Advice on a methane quota system

We do not recommend an MQS be advanced further due to feasibility risks and because the NZ ETS offers an established alternative for a quantity-based instrument

9. We understand that an MQS is being explored as an option for pricing agricultural emissions, additional to options short listed by Ministers previously. We have not received a detailed proposal on an MQS.

10. An MQS would establish an annual capped quota for methane emissions units (i.e. permits), likely set in alignment to New Zealand's emissions budgets. Eligible farmers would acquire their quota (e.g. via an auction or form of allocation) and be able to trade permits in a secondary market, analogous to unit trading under the NZ ETS. Agricultural long-lived gas emissions would be priced through the NZ ETS. There would be no fungibility for the methane quota units with the NZ ETS market for long-lived gases or forestry offsets. By setting a fixed cap on allowable permits for emissions, an MQS provides greater certainty over the quantity of methane emissions from agriculture than a price-based mechanism, like a levy.

11. There are some merits with an MQS. Like the NZ ETS, it would use the market to derive an economically efficient price based on the set cap. It would also include agricultural long-lived gases in the NZ ETS, supporting whole-of-economy trade-offs for these gases.

12. However, we do not recommend advancing an MQS to public consultation at this late stage in the policy process. In short,

    a We view the pursuit of an additional option to those agreed previously by the Climate Response Ministers Group as carrying substantial additional implementation risk, particularly for a farm-level solution.

    b An MQS proposal has not been closely considered by the Government (e.g. it has not been included in business case analysis, quantitative modelling, or implementation planning activities) or by the sector to date.

    c The introduction of an entirely new policy instrument now could delay public consultation, the advancement of meaningful implementation planning and likely introduction of a pricing mechanism for agricultural emissions, and divert resource and focus away from improving already tabled pricing options.

    d A delay to the implementation of pricing may put New Zealand's 2030 targets at risk.

13. If Ministers wish to establish a quantity-based scheme, our recommendation would be to do this using the already-established NZ ETS. The NZ ETS sets a cap on all emissions but does not specify a particular mix of gases or a precise level of gross versus net emissions. In doing so, the NZ ETS drives abatement action at least-cost and allows whole-of-economy trade-offs across emission types and sources. It is the whole-of-economy efficiency advantages of the NZ ETS across all gases and sectors that leads us to prefer it as a policy instrument over a levy.

Section 2: Advice on a levy-based instrument

Pursuit of an effective incentive model now will set the pricing policy up for the long-term

14. A levy-based pricing policy has emerged as the Government's preferred direction for agricultural emissions pricing, subject to further decisions.

15. We recommend that emissions are priced at a level that generates a salient price signal that reflects the underlying cost of the emissions externality to ensure that farmers consider this cost when making decisions.

16. Complementary policies that do not hinder or substitute for the core price signal can then be applied to manage transitional impacts like financial hardship or emissions leakage that result from emissions pricing. These complementary policies should also be appropriately targeted and timebound, with a clearly defined path for removal. Still, in our view it should be the price signal – not complementary measures – that drives emissions reductions. The importance of relying primarily on pricing to incentivise mitigation is likely to increase over time as greater emissions reductions are required to achieve our 2050 targets.

17. With this long-term view in mind, we see particular importance in designing a durable levy pricing system that can be built on and enhanced over time. There is also benefit in instituting a levy policy that more closely aligns to the NZ ETS. As currently proposed, the pricing system would not rely primarily on emissions pricing to drive emissions reductions. Instead, the levy would primarily be used to raise revenue to fund incentive payments. We have concerns with the effectiveness of such an approach, as well as the ability for it to be enhanced over time. We recommend against narrowing specific levy design options too soon and to ensure that options presented for public consultation remain suitably flexible in their scope to enable informed public discourse whilst avoiding constraining final policy decisions.

Lead agencies' proposal

18. Based on our current understanding of lead agencies' proposal, they are recommending the following model:

    a A long-lived gas levy: The levy price would be tethered to the NZ ETS unit price (**NZU**). A proportional discount would then be applied, which discounts the prevailing NZ ETS unit price by a specified amount (the current proposal is for an initial 95% discount, declining at 1% per annum). Despite currently high NZU prices, a discount of this scale would result in a low long-lived gas levy price,

    b A methane levy: The levy price would be set relative to the agriculture sector's performance against New Zealand's gross methane targets, with over performance against targets resulting in a lower levy price and vice versa. s9(2)(f)(iv) s9(2)(f)(iv), and

    c Incentive payments for mitigation actions: These would be rewarded at a rate higher than the levy price to incentivise uptake but netted off directly from the combined levy liability. These mitigation actions would also reduce the future emissions levy liability by reducing the quantity of emissions emitted (for one or both levies, depending on the type of mitigation action taken).

19. As a summary, an emissions liability would be calculated as:

	Emissions liability	=	Long-lived gas levy	+	Methane levy	-	Incentive payments
Price setting			Based on the NZ ETS unit price		Set relative to Agriculture's performance against gross methane targets, where overperformance against targets lowers the levy price, under performance raises levy price		Paid at a rate higher than the levy to encourage uptake of mitigation actions (e.g. low emissions technologies and practices)
Financial Assistance			Rebate applied using a proportional applied at 95% initially (declining 1% per annum)		TBC how assistance would be applied		'Incentive payments' are being applied as a form of structured financial assistance

20. Agencies have also identified three pathways for rewarding additional on-farm vegetation categories for **sequestration**:

    a Include these new categories in the NZ ETS by expanding eligibility criteria,

    b Integrate sequestration into an agricultural farm-level levy, or

    c Reward sequestration as a use of funds by the levy.

21. Recognising the significance of sequestration as a policy issue, we understand that lead agency officials have not identified a preferred option at this time.

22. We have identified several risks with the current proposal and have made a series of associated recommendations that we think should be reflected in the consultation document. If accepted, we think these changes would improve the effectiveness of the incentives for emissions reduction, providing a strong foundation for supporting New Zealand's climate strategy and the Government's economic vision

Treasury recommendations for setting levy prices

Long-lived gas levy

23. We are supportive of setting levy prices in an independent and economically sound manner, including lead agencies' proposal to use the NZ ETS market to derive the long-lived gas levy price.

Methane levy

24. **Risk:** Setting the methane levy relative to performance against domestic targets may limit trade-offs across the economy and the application of an adaptive management approach to meeting targets, which:

    a Creates risk to the achievement of the NDC as this net target would not be explicitly considered when setting the methane levy rate. This in turn could increase the shortfall of domestic mitigation needed to meet our NDC and increase reliance on purchasing offsets,

    b Inhibits the ability to take advantage of overperformance in the agriculture sector that could balance out potential underperformance from other sectors to support a more cost-effective transition.

25. We also expect that, based on preliminary modelling results, the resultant levy price would be low for methane, which may not reflect the emissions externality.

26. **Recommendation:** For setting the price of the methane levy, we recommend avoiding constraining trade-offs by exploring either:

    a Tethering it to the NZ ETS unit price (e.g. applied using standard emissions conversion factors), or

    b Setting levy prices based on independent advice from the Climate Change Commission ("the Commission"). If Ministers pursue a non-market derived price option, it is recommended that the Commission consider a wider range of factors than simply progress towards our methane targets to support trade-offs between sectors.

Treasury recommendations for complementary policies for financial assistance

27. We support exploring the application of financial assistance as a complementary policy to facilitate the sector's transition. **Section 4** outlines our advice on the role of financial

assistance within the broader context of supporting an appropriately paced transition that aligns to the Government's economic vision. This section focusses on specific recommendations for *how* assistance could be effectively applied.

28. Lead agencies have proposed two forms of financial assistance: **a proportional discount** applied to the long-lived gas levy (that reduces over time) and **incentive payments for mitigation actions**. The setting of the methane levy at a low price could also be considered a form of financial assistance.

29. **Risk:** Mitigating adverse impacts on the sector by keeping levy prices low and relying on incentive payments to drive abatement may not support achievement of our 2050 targets.

30. We caution against this approach. In particular:

    a Low levy prices may not fully reflect the emissions externality. There is also an increased chance that farmers do not understand or face the full cost of their on-farm emissions as levies and financial assistance (incentive payments and proportional discounts) would be bundled together into one price (see paragraph 19 above).

    b While it may support achievement of near-term targets, the proposed approach to financial assistance may not support the deeper reductions needed past 2030 to achieve New Zealand's 2050 targets.

    c Incentive payments generate a fiscal sustainability risk as, to incentivise uptake under a low levy price, mitigation actions would have to be paid out at a rate higher than the levy. This risk would increase if demand for incentive payments is high.

    d There is an increased risk of price volatility if levy rates must be adjusted to account for changes in demand for incentive payments.

    e Application of incentive payments double-counts incentives. Avoiding payment of an emissions price by reducing on-farm emissions is the underlying incentive driven by pricing emissions. Investment in emissions reduction yields a benefit of avoided emissions costs over time. Incentive payments that significantly subsidise that investment therefore 'double-up' the benefits farmers receive for emissions reductions without necessarily driving additional reductions to those the price incentive would deliver.

    f It may constrain the ability to improve the system in the future as there are limited options available other than accelerating its removal.

31. **Recommendation:** Given these risks, our view is that lead agencies should undertake further analysis on financial assistance methods before Ministers take final policy decisions. We recommend that:

    a An output-based method of financial assistance be included in public consultation as recommended by the Climate Change Commission as their preferred form of assistance,

    b In parallel to public consultation, lead agencies conduct further options analysis on forms of financial assistance that support a salient price signal and do not overly rely on incentive payments to drive abatement. In undertaking this work:

        i If an output-based form of assistance is investigated, consideration could be given to practical interim approaches to estimating farm output (e.g., including exploring proxy measures of output as a starting point).

ii If it is identified there is a need to support mitigation action uptake through incentive payments (e.g., addressing capital access barriers), then this should be considered as a potential form of targeted assistance assessed on a case-by-case basis rather than as a mainstay of the incentive model.

32. There is a tension between developing and implementing form(s) of financial assistance which meet the objectives of pricing and ensuring that a price on agricultural emissions is in place by 2025. Our view is that starting to price emissions and building on this system in time is of primary importance. If it is not possible to implement financial assistance that preserves strong incentives by 2025, then we acknowledge that it may be necessary to start with lower levy prices to avoid widespread financial hardship. However, to achieve New Zealand's long-term climate targets and ambitions, this approach would need to be improved within a short period of time.

33. Reflecting this, we also recommend that review date(s) be set at specified interval(s) post-2025 to evaluate the ongoing effectiveness and need for financial assistance.

Treasury recommendations for managing sequestration

34. **Risk:** Including sequestration in the agricultural emissions pricing system substantially increases implementation complexity and, if integrated directly into a farm-level system, may not be efficient and inequitable.

35. We strongly recommend against rewarding any sequestration outside of the NZ ETS. There may be merit in expanding NZ ETS eligibility criteria, provided this sequestration could be counted against our domestic and international targets, but we would have significant concerns about the fairness and inefficiency of limiting recognition to a particular sector. Including sequestration in the farm-level system will exacerbate fiscal sustainability risks of the system, particularly if levies are low.

36. Including sequestration in the pricing work programme will add significant risk and complexity to implementation, regardless of whether this is done via the NZ ETS or a farm-level levy system. s9(2)(g)(i)
s9(2)(g)(i)

37. **Recommendation:** If Ministers wish to investigate recognition of additional forms of sequestration, we recommend that:

a Sequestration be channelled via the NZ ETS to support an efficient and equitable approach,

s9(2)(f)(iv)

d The sequestration workstream be separated from the critical path of implementing the core pricing policy, and

s9(2)(f)(iv)

s9(2)(f)(iv)

Treasury recommendations for fiscal sustainability

39. Overall, the incentive model may be prone to fiscal sustainability risks resulting from the combination of low levy prices and uncertain scope and demand for incentive payments. This risk would increase if sequestration were included within the levy system itself. Our recommendations above help address this risk.

s9(2)(f)(iv)

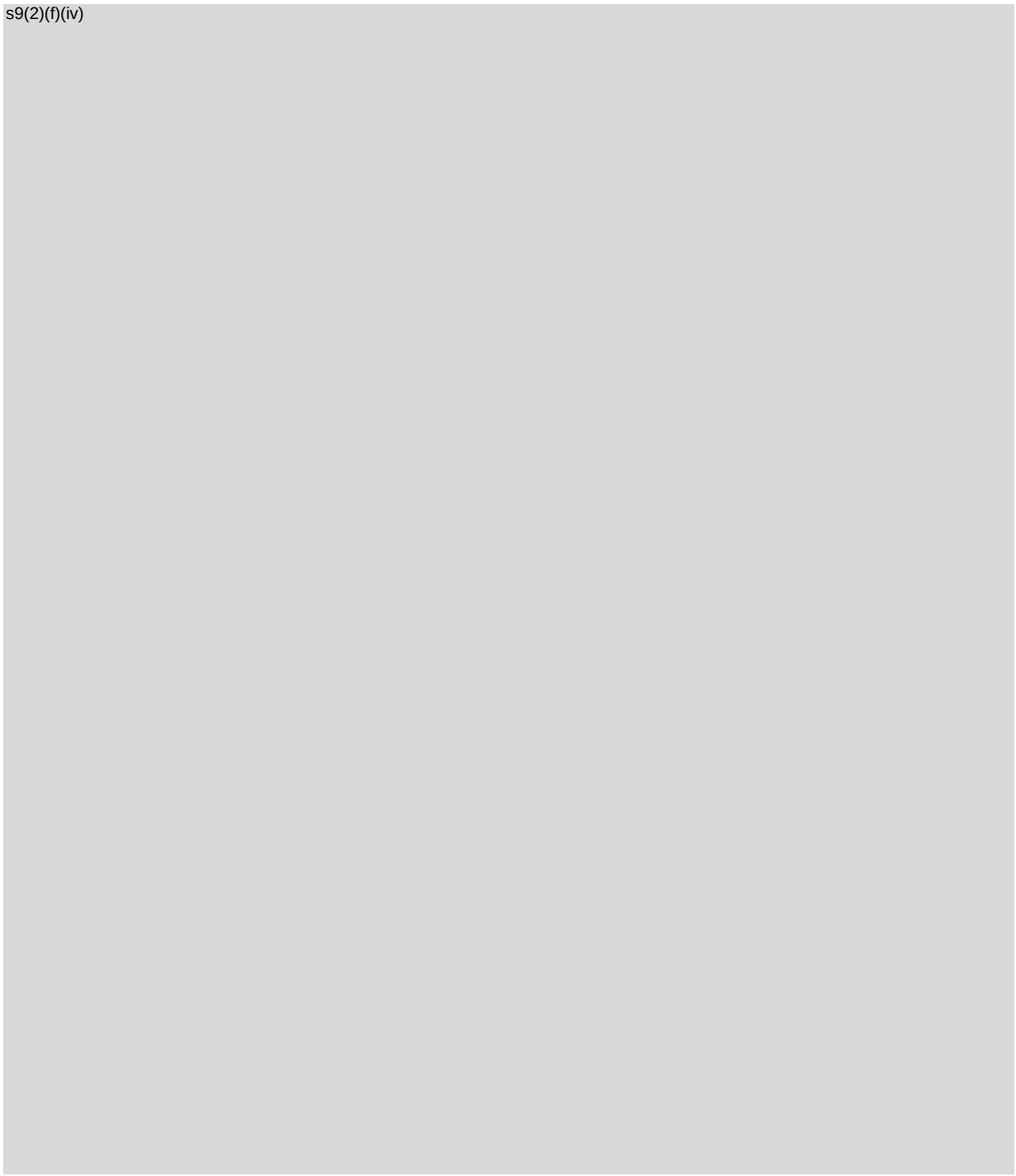
Treasury recommendations for pricing nitrogen fertiliser

41. In line with our previous advice, we recommend pricing nitrogen fertiliser at the processor-level via the NZ ETS due to administrative simplicity, increased coverage of fertiliser emissions, better allowing whole-of-economy trade-offs to occur in the NZ ETS, and that processors have, in our view, greater control over the emissions from fertiliser. This option should be included in public consultation.

Section 3: Addressing implementation concerns

s9(2)(f)(iv)

s9(2)(f)(iv)



Section 4: Economic implications of pricing and facilitating a paced transition

Pricing agricultural emissions aligns to your economic vision…

52. We expect to see structural change across land-based primary industries because of pricing, given the historic lack of incentives addressing the sector's emissions and the implicit subsidy that it has received to date. In some places there are likely to be existing land uses that are no longer viable when facing the full costs of their production (i.e., including externalities). There may also be categories of land use that become less viable overall.

53. Pricing agricultural emissions will also help establish the right incentives to capitalise on medium-to-long-term trends that support New Zealand's economic security and realising higher wages. For instance, pricing may position our primary sector to secure green product premiums (with alternative plant-based proteins forecast to represent between 11% – 22% of global protein consumption by 2035[1]), sustain market access in the long-term to high value export markets, and strengthen incentives for private sector innovation in low emissions technologies.

… but the pace of structural change will need to be managed

54. However, it is important that structural change is signalled well in advance and appropriately paced to support the agriculture sector's resilience, the development of new supply chains, mitigate risks of emissions leakage, and uphold the Government's commitment to a just and equitable transition.

55. When making decisions on the pricing policy, Ministers will need to manage the tension between near-term economic security (such as supporting food security and trade) and the scale and pace of the change needed by the sector to deliver on our climate targets. Structural change will be beneficial and needs to occur; but abrupt, poorly signalled change is unlikely to support the delivery of the Government's economic vision either.

Modelling predicts rapid structural change – but changes to assumptions could alter the results substantially

56. Lead agencies commissioned modelling from Manaaki Whenua Landcare Research Limited (**MWLR**) to examine impacts across a processor-level NZ ETS, processor-level split-gas levy, and farm-level split gas levy. **Annex 1** summarises preliminary results.

57. Preliminary results show rapid structural change by 2030 and fundamental changes to the mix of commodities from our primary sectors across all policy scenarios. For instance, red meat subsectors experienced large decreases in production and net revenue. Dairy had more moderate decreases. Conversely, forestry and scrub land increased (based on area), which, could have implications for employment as permanent forest typically has less employment per hectare than livestock farming. Lastly, horticultural and arable farming also increased (based on area), although to a lesser extent than forestry. Distributional impacts are likely to be felt by Māori, with Māori estimated to operate up to 25% of New Zealand's sheep and beef farmland. Impacts would be greater in regions with higher proportions of red meat farming or those with higher proportions of lower quality land (and fewer available options for high productivity alternative uses).

58. While the modelling provides a useful indicator of the degree of structural change and its distributional impacts, the results are not final. Pricing assumptions were not treated consistently across options and financial assistance was modelled using a proportional discount – thus not retaining incentives for high levels of production, partially explaining

[1] Boston Consulting Group (2022), *The Untapped Climate Opportunity in Alternative Proteins.*

the pace of land use change predicted. We understand after peer review the lead agencies have requested further updates to the base scenario modelling, which may change the quantum of impacts (although we would expect not the overall direction).

59. Notwithstanding our view that structural change is necessary and presents opportunities and that the results are preliminary, if change were to occur at the pace predicted, this would likely cause significant disruption for the sector, supply chains, and impacted communities.

You have choices over the pace of transition

60. Government has control over policy levers that can be used to accelerate or slow transition. For example, the government can:

    a Send early, clear, and credible signals to the market to provide regulatory and policy certainty through commitments, like the Emissions Reduction Plan.

    b Adjust adjacent policy settings to reduce friction in transition (e.g., like supporting the development of new supply chains and execution of industry transformation plans).

    c Introduce non-financial forms of assistance. The Government has committed to delivery of several initiatives totalling $463 million funded in Budget 2022, such as farm advisory services or the Centre for Climate Action on Agricultural Emissions, which may offer important insights on technology innovation domestically.

    d Introduce financial forms of assistance, reflecting the Commission's finding that financial assistance should be provided to the agriculture sector where material financial hardship is expected[2]. Government has control over the method of assistance, its starting level, and rate of removal. Our advice on financial assistance in **Section 2** has considered its role supporting broader transition objectives.

s9(2)(f)(iv)

Next steps for our advice

62. You will be meeting with Cabinet on 3 October to take decisions on the policy options to be included in public consultation.

63. Following public consultation, the Government will release a report in December outlining how it will price agricultural emissions. We will provide further advice to you in November to support these decisions.

[2] Climate Change Commission (2022), *Advice on Agricultural Assistance*.

Annex 1: Summary of preliminary MWLR modelling results

Key points from MWLR modelling:

- There are large structural changes to the mix of land use types across all policy options modelled with financial assistance provided initially at 95% in 2025 (declining 1% per annum) on a proportional discount basis.
- Land use change was particularly pronounced for the NZ ETS option in part because of the higher methane emissions prices modelled for this option relative to the other policy scenarios modelled (i.e., modelled inputs of 30.4c per kg in 2030 for the NZ ETS option versus 14.1c per kg in 2030 for the farm-level levy option).[3] We would expect greater equivalency in outcomes if comparable prices were used.
- Impacts were particularly high for the red meat subsectors because these farms tended to have lower net profit per unit of output, higher emissions intensity per unit of output, and fewer mitigation options available than dairy farms.
- Key drivers in the model are the relative costs and elasticities of the different emissions reduction pathways and the changing relative profitability of different land uses. For instance, land use change towards forestry and scrub was more cost-effective vis-à-vis farm system efficiencies and technology mitigations. The shift in land use away from red meat and dairy then results in the observed decreases in production and net revenue for these subsectors.
- The modelling suggests low uptake of on-farm mitigation technologies, and this may be sensitive to the underlying cost input assumptions for these technologies. For instance, when mitigation technology costs were assumed to be cheaper under a 'tailwinds' scenario, this saw a relatively large increase in uptake of these technologies and reduced land use change.
- Changes modelled are the incremental impacts of agricultural emissions pricing only. They do not include cumulative effects of other policies, such as freshwater policy.

We have presented preliminary modelling results below. We understand that a peer review has been undertaken and these results may adjust accordingly. However, lead agencies expect that the results will directionally hold.

[3] Prices stated without the proportional discount applied. The methane price modelled was based on the Partnership's methane price of 11c/kg, inflation adjusted.

Table: Summary preliminary MWLR modelling results[4]

	NZ ETS Backstop	Processor-level split gas levy	Farm-level Levy
Pricing assumptions (in 2030)			
NZ ETS price ($ per tonne CO2e)	$108.86	-	-
$ per tonne CO2e after 90% free allocation[5]	$10.86	$5.02	
Methane price cents per kilogram[6]	30.4 cents	14.1 cents	
Emissions			
Gross emissions (all sectors)	-18.1%	-11.9%	-14.5%
Methane	-18.8%	-12.3%	-15.1%
Commodity production			
Milk Solids (t)	-9.8%	-6.4%	-5.3%
Lamb (t)	-23.1%	-13.1%	-21.4%
Beef (t)	-64.7%	-52.2%	-36.7%
Arable, fruit, and vegetables (t)[7]	8.8%	4.9%	5.2%
Net revenue			
Dairy	-11.1%	-7.2%	-7.4%
Sheep and beef	-35.4%	-21.8%	-29.8%
Arable, fruit, and vegetables	6.3%	3.5%	4.0%
Land-use change			
Dairy	-6.1%	-3.2%	-2.7%

[4] Results provided by lead agencies based on Manaaki Whenua Landcare Research Limited (2022), *unpublished*. Percentage change to business as usual policy scenario in 2030. All results represent the pessimistic mitigation technology uptake scenario (where costs for mitigation actions are higher).
[5] After starting at an initial level of 95% in 2025, declining 1% per annum to 2030.
[6] Conversions between gases based on AR5 GWP values. Inflation adjusted.
[7] Covering wheat, barley, maize, berryfruits, kiwifruit, and vegetables.

	NZ ETS Backstop	Processor-level split gas levy	Farm-level Levy
Sheep and beef	-19.9%	-11.2%	-17.8%
Indigenous forest / scrub	18.2%	10.1%	15.7%
Arable, fruit, and vegetables	8.4%	4.7%	5.0%

TE TAI ŌHANGA
THE TREASURY

Reference: T2022/2098

Date: 21 September 2022

To: Minister of Finance (Hon Grant Robertson)

Deadline: 22 September 2022

Supplementary advice on agricultural emissions pricing to support ministerial consultation

Purpose

1. This advice supplements Treasury's recent advice on agricultural emissions pricing policy options, provided to you on 14 September [T2022/1789]. Our advice is based on updated policy proposals in the draft Cabinet paper that is currently being circulated for Ministerial consultation.

Additional advice

Treasury's overall assessment of the current levy proposal

2. The pricing of agricultural emissions is a vital step for achieving our domestic and international climate commitments and delivering on the Government's economic strategy. We reiterate previous advice on the importance of establishing a pricing system now that can be built on and enhanced over time to support the achievement of our long-term climate objectives. Our previous advice contained recommendations on how to improve the levy proposal, and updated improvements with reference to the current proposal are provided in the section below.

3. Nevertheless, the Treasury has significant concerns with the levy proposal tabled and think that a more effective levy system is achievable by 2025.

4. If accepted as is, our view is that this proposal risks locking-in a pathway that may be difficult to enhance in future and therefore may not set the foundation needed to deliver on our longer-term climate objectives. We believe the incentive model generates a significant fiscal risk, with the combination of low levy prices and uncertain demand for incentive payments (rewarded at a rate higher than the levy price), as well as recognition of on-farm sequestration.

5. This proposal relies heavily on as-yet-unavailable technologies to deliver emissions reductions. We see material risk that the model will not deliver the scale of behavioural change and abatement needed over the long-term to achieve New Zealand's targets beyond 2030.

6. More broadly, if the system is not efficient in delivering the scale of abatement required from the agriculture sector, it will have ramifications for the cost of our overall climate transition, particularly increased costs to meet our Nationally Determined Contribution. This may shift the onus and costs of our transition to other sectors, which undermines economically efficient outcomes, economic resilience, and fairness across other sectors. Lastly, notwithstanding industrial allocation in the NZ ETS for some industries, the combination of a low levy price, incentive payments and additional forms of sequestration only available to the agriculture sector would be a significant departure from the approach to emissions pricing for other sectors. This, in turn, may impact the credibility and durability of the pricing system.

7. We are also concerned that the consultation paper does not sufficiently explore alternative options for key design elements that could help inform final policy decisions if changes are deemed to be necessary post-consultation. We remain of the view it is narrowing some options too soon. For instance, options for alternative forms of financial assistance are not included.

Updates to our previous advice to enhance the current levy proposal

8. **Price setting:** The paper proposes that the methane levy would be set relative to targets and, in some circumstances, consider broader socio-economic factors as well. The methane levy would be set by Ministers on advice from the Climate Change Commission (the Commission). While we support the Commission advising on price setting, we consider that all targets, domestic and international (net and gross), should be considered and this advice should be taken in parallel with the Commission's advice on NZ ETS unit supply and price settings, to allow a whole-of-economy approach to be applied. We recommend the proposal be updated to reflect this.

9. The paper also recommends consulting on two options for the frequency of levy setting: annual or three-yearly. We have not considered this element in depth but will provide subsequent advice ahead of final decisions being taken to ensure an appropriate balance is struck between price stability and regular reviews to ensure effectiveness of the levy. At this stage, we support consulting on both options.

10. **Incentive payments:** The paper proposes that incentive payments would be netted off against levy liabilities *before* the calculation of levy revenue and the funding of administration costs. Our first-best advice is for incentive payments to applied in a time-limited and targeted manner, rather than on an ongoing and sector-wide basis, reflecting they should not be the mainstay of the overall incentive model [T2022/1789]. However, if incentive payments are to be included in the levy proposal, we instead recommend that these payments be funded from levy revenue *after* first meeting the costs of the system's administration. This approach would enable trade-offs to be applied to competing demands on levy revenue and would help ensure the system remains self-funding.

11. **Sequestration:** The paper proposes that additional on-farm vegetation is recognised as sequestration through a contractual mechanism in 2025 until it can be managed in the NZ ETS at a future point.

12. Consistent with our earlier advice [T2022/1303 and T2022/1789], we do not support this approach and remain firmly of the view that sequestration is best

managed through the NZ ETS. We consider the proposed approach is likely to lock in a pathway that will not transition to the NZ ETS later. There is also significant uncertainty over the actual sequestration benefits these categories of vegetation will deliver, the quantum of vegetation that would be eligible (and therefore the likely costs to reward it), and whether this vegetation would count towards the achievement of our targets.

13. Our advice remains that sequestration should be decoupled from agricultural emissions pricing, with a clear commitment to investigate expanded NZ ETS eligibility criteria based on robust analysis. If genuine sequestration benefits are found, this should be available to all landowners, not just agriculture.

Advice on additional proposals not covered by our previous advice

14. The Minister of Climate Change is seeking Cabinet agreement to consult on a methane quota system. The Minister is has also proposed:

    a **A more rapid phase-out of the proportional discount on the long-lived gas levy** (1% per annum until 2030, 2% between 2030 and 2040, and 3% thereafter).

    Conversely, the Minister of Agriculture recommends applying a 95% proportional discount to the price, and phasing it out at 1% per annum, as set out in the NZF-Labour 2017 coalition agreement.

    s9(2)(f)(iv)

    b **Levy revenue be used to repay the Climate Emergency Response Funding (CERF) for the Centre for Climate Action on Agricultural Emissions (CCAAE) and to fund the costs of agriculture's contribution towards meeting the purchase of any international offsets for our NDC**.

    We support exploring options for using any excess levy revenue to fund the CCAAE, given agriculture does not currently contribute to CERF via NZ ETS proceeds. However, given the significant demands on the levy revenue, we do not expect significant amounts of excess levy revenue.

    The fiscal implications of meeting our NDC through offshore mitigation are expected to be significant. We think further analysis of the Minister of Climate Change's proposal is needed, particularly the fiscal costs and how they are distributed across the economy. As noted, an effective levy system will likely reduce the fiscal cost of meeting our NDC by reducing the amount of international offsets New Zealand would require.

Additional points to note

15. The paper does not frame the NZ ETS as the central pillar of New Zealand's strategy to address climate change. s9(2)(f)(iv)
    s9(2)(f)(iv)

s9(2)(f)(iv)

16. Land use change has been framed as an issue to manage, rather than an opportunity to take steps towards realising the structural change needed to secure the Government's economic vision. As advised previously [T2022/1303 and T2022/1789] it is the pace of change which needs to be managed and the government has choice over this.

17. We do not consider that the modelling results portray the relative policy impacts of the three proposals in a balanced manner. For instance, the levy proposals have been modelled at significantly discounted prices relative to the NZ ETS backstop (e.g., the NZ ETS methane price was modelled at 30.41c per kg CH_4, whereas the farm level levy was modelled between 8c to 14c per kg CH_4). During public consultation, it is recommended that additional modelling test the same price inputs across all options to understand the incremental impacts of the levy relative to the backstop.

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