ANZ Research

NZ Insight: Government recommendations for pricing agricultural emissions

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Contact

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Agricultural emissions pricing recommendations

Today the Government released its proposed pricing of agricultural emissions, which is now being consulted on. The consultation period runs until 18 November 2022, with ministerial approval expected in early 2023.

Many, but not all, of the proposals put forward by He Waka Eke Noa (the Government and industry partnership) are included in the Government proposal.

Key points

- The Government agrees that a split-gas approach should be taken. This means the price of methane will not be linked to the carbon price.
- Emissions are to be priced at a farm level, but the Government has put in place a caveat that if processes are not in place by 2025, then emissions will be priced at the processor level. If a processor-level approach is taken then this will simply reduce farmgate pricing, unless the processors hold sufficient information on their suppliers to differentiate pricing. At present dairy processors are a lot better set up to implement differential pricing than the meat processors are.
- The pricing of methane emissions will be revised periodically (annually or every three years) based on advice from the Climate Change Commission (CCC). It was hoped that the agricultural industry would have had representation within the group that provided advice to the Government on pricing but this proposal has not been accepted. The CCC lacks practical agricultural knowledge so will need to consult closely with farmers so that the impact of pricing decisions is fully comprehended.
- The Government has not committed to putting a ceiling on emissions pricing. He Waka Eke Noa recommended a maximum price for methane of 11c/kg for the first three years (until 2028) but this has not been included in the Government proposal.
- The Government has not settled on a method to price fertiliser emissions. This could be done at the farm level (as recommended by He Waka Eke Noa) or at the processor level (as recommended by the CCC).
- Incentive payments will be made to farmers for taking approved actions, such as changes to farm management practices and adopting new technology.
- One of the major differences between the Government proposal and that of He Waka Eke Noa is how on-farm sequestration is treated. The Government proposal includes some reward for riparian plantings and sequestration that occurs due to stock exclusion. However, the range of types of vegetation included is much narrower than was proposed by He Waka Eke Noa, and the Government is wanting this to be only a short-term solution, with all rewards for sequestration eventually occurring through the Emissions Trading Scheme (ETS).

What does this mean for NZ's agricultural sector?

Today's proposals from the Government will not come as a surprise to those who have been following this topic. The changes to recommendations initially put forward by He Waka Eke Noa are largely aligned with the CCC recommendations.

The Government proposal is less favourable to agriculture than the proposal initially put forward by He Waka Eke Noa as it provides less certainty for emissions price levels, it does not allow for the industry to be directly involved with the process to recommend emissions pricing to Government, and rewards less on-farm sequestration.

The methane price is very dependent on how quickly emissions can be collectively reduced by the agricultural industry. Unfortunately, this does not provide individual agricultural businesses with much certainty as to what their future liabilities will be. If emissions are quickly reduced, the price will not need to be ratcheted up.

It is clear the proposal is less favourable for our sheep and beef farms. This sector tends to generate greater methane emissions relative to the value of the production than the dairy industry and the level of profitability in this industry tends to be lower. The sheep and beef sector stood to gain the most from the proposal to reward a wider range of on-farm vegetation as these farms tend to have unproductive areas, such as gullies, which could be planted in trees.

These factors, combined with the high carbon price, will continue to incentivise land-use change towards planting trees that can generate carbon credits, particularly pine trees. Unfortunately, we are yet to see any policies that encourage small areas of land to be planted in trees, which could help to keep the more productive parts of farms producing food and fibre.

The Government proposal for pricing of agricultural emissions is now due to be approved by Ministers in early 2023, rather than late 2022 as initially proposed. The Government has also put in place back-up measures should the systems to price emissions at the farm level not be ready by 2025. This involves pricing emissions at the processor level, which again is likely to be less favourable for the sheep and beef sector. A blanket reduction in farmgate prices is likely to occur, which would do little to incentivise changes in on-farm practices.

Pricing emissions at the processor level is expected to have a greater impact on both farm profitability and land-use change than pricing emissions at the farm level. Under a processor level levy there is expected to be a 20%[1] decrease in land used for sheep and beef farming, and up to a 5.7%[2] decrease in land used for dairying according to the modelling by MPI.

Government modelling indicates there will be significant decreases in agricultural production. Depending on the scenario, the decreases expected could be as great as 9.8% for milksolids, 23.6% for lamb and 65.4% for beef. The arable, horticulture and forestry sectors are expected to benefit from the proposals due to land-use change.

In summary, the Government proposal was largely as expected. There will be significant change in our primary sectors as the impact of pricing agricultural emissions are taken into consideration. Dairy and meat production will decrease, but this will provide some opportunity to increase the average value of these goods. Production of horticultural goods and arable goods is expected to increase, but this will require significant additional investment.

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[1] Decrease in sheep and beef land ranges from 19.7% to 20.0% depending on the scenario used.

[2] Decrease in dairy land ranges from 5.3% to 5.7% depending on the scenario.

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