

# SUBMISSION

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Submission on: **New Zealand Emissions Trading Scheme Review 2015/16**

From: **Federated Farmers of New Zealand**

Date: 19 February 2016

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## **SUBMISSION TO THE MINISTRY FOR THE ENVIRONMENT ON NEW ZEALAND EMISSIONS TRADING SCHEME REVIEW 2015/16**

### **1. INTRODUCTION**

- 1.1 Federated Farmers welcomes the opportunity to provide this submission to the Ministry for the Environment on the New Zealand Emissions Trading Scheme (ETS) Review 2015/16. This submission is on the 'Priority Issues'.
- 1.2 Federated Farmers agrees that it is timely to review the ETS to assess its operation and effectiveness, especially in light of international developments that may result in a strengthened response to climate change and potentially higher carbon prices.
- 1.3 Although biological emissions from agriculture make up almost half of New Zealand's total emissions, this is unique among developed economies and currently the only way to significantly cut these emissions would be to reduce livestock numbers and limit production. Federated Farmers therefore agrees with the Government's decision to exclude these emissions from the scope of this review.
- 1.4 Federated Farmers takes the issue of climate change and policy responses, like the ETS, seriously. Farmers, alongside other households and businesses, bear the burden of the ETS through carbon costs applied to transport fuels and electricity used.
- 1.5 It is primarily with this in mind that Federated Farmers submits on this 'priority issues' stage of the review. We will also be submitting separately on the 'other matters' stage of the review and we remain committed to the development of an alternative policy framework for dealing with agricultural emissions

### **2. SUMMARY OF RECOMMENDATIONS**

- 2.1 Federated Farmers recommends that
  - (a) The one-for-two surrender obligation should be maintained as a transitional measure.
  - (b) The \$25 fixed price surrender option should be maintained.

### **3. BIOLOGICAL EMISSIONS FROM AGRICULTURE**

- 3.1 Federated Farmers agrees with and is appreciative of the Government's decision not to include biological emissions from agriculture within the scope of this review of the ETS.
- 3.2 There is much misinformation about the exclusion of biological emissions from agriculture with some opponents to its exclusion claiming that agriculture as a whole is 'exempt' from the ETS. This is simply not true. Farmers, alongside other households and businesses, bear the burden of the ETS through carbon costs applied to transport fuels and electricity used both by themselves and by dairy and meat processors where their energy and transport costs are passed back to farmers through prices paid for milk and

for livestock respectively. Farmers are also active participants in the ETS through their pre-1990 and post-1989 forests, in turn bearing the exposure to and obligations of owning such forests.

- 3.3 New Zealand has a very positive story to tell. According to the New Zealand Agricultural Greenhouse Gas Research Centre (NZAGGRC):

*The increasing efficiency and productivity means that the total greenhouse gas emissions per unit of agricultural product (that is, per kilogram of meat or milk solids) have declined and are about 20 per cent less today than in 1990.*

*However, the story does not end there. New Zealand agriculture may be more efficient than ever, but it also produces more food than ever - particularly in the dairy sector, where milk solids production has nearly tripled since 1990.*

*Overall, greenhouse gas emissions from agriculture in New Zealand have increased by 12 per cent between 1990 and 2011. Without the improved efficiency, agriculture's total emissions would now be 30 per cent greater than in 1990.<sup>1</sup>*

- 3.4 As noted in the discussion document, the Government considered the exclusion of biological emissions from agriculture in its previous review of the ETS in 2011 and it decided that these emissions would be included in the ETS only if:

- There are economically viable and practical technologies available to reduce emissions; and
- Our trading partners make more progress on tackling their emissions.

- 3.5 These conditions are very pragmatic and sensible. Federated Farmers strongly believes that were New Zealand to impose significant costs on food production through, for example, applying the ETS to agricultural (biological) emissions without these conditions being met it would harm the competitiveness of New Zealand's productive and efficient farmers. Significantly in the context of climate change it would also mean that food production would be picked up by less productive and less efficient farmers offshore which would be counter-productive for global emissions.

- 3.6 The discussion document notes, and Federated Farmers agrees, that while there has been some progress towards meeting these conditions, they have not yet been met. We would add that the conditions are probably still some way off being met.

- 3.7 It is important to recognise that the December 2015 Paris meeting on climate change saw considerable discussion and agreement on the need to prioritise food security and food production. Including food security as a priority, as well as flexibility in implementation and the provision of assistance to developing countries, was instrumental in getting developing countries on board and the key to a comprehensive deal which sets all countries on the same journey.

- 3.8 It is also important to recognise that farmers have for many years invested in research into reducing agricultural biological emissions through the Pastoral

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<sup>1</sup> Harry Clark (Director of the NZAGGRC) opinion piece in *Dominion Post*, 16 April 2014 reproduced on NZAGGRC website <http://www.nzagrc.org.nz/news.listing.117.financial-imperatives-in-reducing-emissions-.html>

Greenhouse Gas Research Consortium and the Global Research Alliance. We understand that this research is making progress but it will take time to find a solution to substantially reducing methane emissions from livestock.

- 3.9 Federated Farmers therefore believes that continuing to exclude biological emissions from agriculture is pragmatic and sensible.

#### **4. PRIORITY ISSUES**

- 4.1 Turning to what is 'in' the ETS and therefore within scope of this review, electricity and fuel are crucial inputs for farming. According to Statistics NZ's 2011 *Energy Use Survey of the Primary Sector*<sup>2</sup>, agriculture (on-farm) used around 15,707 terrajoules of energy, or around 5 percent of all energy used in New Zealand. This includes:
- 1,258 million kilowatt hours of electricity.
  - 80 million litres of petrol.
  - 196 million litres of diesel (mostly used 'off-road').
- 4.2 There are around 58,000 agricultural businesses in New Zealand, so this means the average farm<sup>3</sup> would in a year use around:
- 21,700 kilowatt hours of electricity.
  - 1,400 litres of petrol.
  - 3,400 litres of diesel.
- 4.3 Most farms are small businesses, but these average annual amounts would all be significantly larger than an average household's use of electricity and fuel. For example, average household use of electricity is around 8,000 kilowatt hours, a little more than a third of that of an average farm.
- 4.4 It is also important to consider energy use of food processing as its energy costs are in effect passed on to farmers through the prices they receive from them for their production. In 2012 the food, beverage and tobacco manufacturing sector used 61,460 terrajoules of energy<sup>4</sup> – four times as much as the entire (on-farm) agricultural sector:
- 4.5 Turning back to the discussion document, the two 'Priority Issues' in the ETS Review are:
- Moving to full surrender obligations
  - Managing the costs of moving to full surrender obligations
- 4.6 These would have impacts on energy costs for agriculture and for food processing.

#### **Full Surrender Obligations**

- 4.7 Moving to full surrender obligations would mean removing the one-for-two surrender obligation. This was introduced in 2009 as a transitional measure to moderate the initial impacts of the ETS on businesses and households.

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<sup>2</sup> *Energy Use Survey: Primary Sector 2011*, Statistics NZ, October 2012

<sup>3</sup> Some farms would use considerably more than the average, for example irrigated dairy farms which are heavy users of electricity.

<sup>4</sup> *Energy Use Survey: Industrial and Trade Sector 2012*, Statistics NZ, October 2013

- 4.8 Federated Farmers believes this measure should remain in place. We note NZIER's report *Economic Impacts of Removing NZ ETS Transitional Measures*<sup>5</sup>. The report stated that agricultural industries would be "negatively affected, driven in large part by the negative impact on energy-intensive food processing".
- 4.9 The submissions of Dairy NZ, the Red Meat Sector, Fonterra, and the Dairy Companies Association of NZ all discuss the impacts that moving to full surrender obligations would have on farmers and processors alike. All four submissions discuss initiatives that have been taken and the progress that has been made to reduce energy and fuel consumption but all also note that the nature of the industries (on-farm and processing) mean that significant step changes would be difficult and costly in the short-to-medium term.
- 4.10 The Red Meat Sector's submission estimates that a \$5 increase in the price of carbon would impose a cost of \$2.52 per tonne of meat, or \$2.8 million in total. Fonterra's submission estimates that a \$6 increase in the price of carbon from \$4 to \$10 per tonne would impose a cost of 1 cent per kgMS or \$19 million in total. At a carbon price of \$25 per tonne, the cost for meat processors would be \$14.4 million and for dairy processors \$86 million<sup>6</sup>.
- 4.11 Meat and dairy processors are for the most part price takers on international markets so these costs would be passed down to farmers in the form of lower prices paid for their products. DCANZ noted in its submission that if the effective price of carbon were to rise to \$15 per tonne and if the cost increase on dairy processors were fully passed back to farmers, it would equate to a cost increase of \$3,053 for the average dairy farmer<sup>7</sup>.
- 4.12 Falling world commodity prices have made the 2014/15 and 2015/16 seasons extremely challenging on-farm. This is especially for dairy, where most farms will be making losses for two consecutive seasons. However, the challenging environment is not confined to dairy, with negative sentiment across all farming sectors according to Federated Farmers' six-monthly Farm Confidence Survey<sup>8</sup>.
- 4.13 With global supply and demand factors for dairy in particular taking longer than hoped to resolve, indications are that the upcoming 2016/17 is unlikely to see a substantial lift in commodity prices or farm profitability. Therefore, any imposed cost increases on farmers (either directly or passed-on from processors) will be most unwelcome at this time.
- 4.14 Furthermore, there remains uncertainty on the future direction of carbon prices. Although an agreement was struck at last December's Paris climate change meeting, its impact on carbon prices will depend greatly on how it is implemented globally and this could result in volatility in carbon markets. It is therefore sensible to retain transitional measures while markets respond and prices settle.

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<sup>5</sup> *Economic Impacts of Removing NZ ETS Transitional Measures*, NZIER report to the Ministry for the Environment, December 2015.

<sup>6</sup> Draft submissions of the Red Meat Sector and Fonterra shared with Federated Farmers.

<sup>7</sup> Draft submission of the Dairy Companies Association of NZ shared with Federated Farmers.

<sup>8</sup> January 2016 Mid-Season Farm Confidence Survey, Federated Farmers of NZ. A copy of this report is attached.

- .4.15 Federated Farmers recommends that the one-for-two surrender obligation should be maintained as a transitional measure.

### **Managing the costs of moving to full surrender obligations**

- 4.16 Moving to full surrender obligations would involve removing the \$25 fixed price surrender option. As with the one-for-two surrender obligation, this was introduced in 2009 as a transitional measure to do with the impact of price spikes or excessive costs.
- 4.17 As with the discussion above on the one-for-two measure, Federated Farmers believes that the \$25 fixed price should be retained. The prospect for carbon prices rising above \$25 is unlikely in the short-term, and as the NZIER report notes until that happens there would be little material impact from its removal. However, if it were to happen an increase in the carbon price to \$50 per tonne is estimated to cost meat processors \$28.8 million and dairy processors \$171 million<sup>9</sup>. It would also increase electricity and fuel costs for farmers, with an increase in the carbon price from \$25 to \$50 per tonne costing an average farmer around \$587 per year<sup>10</sup> or \$33.9 million for agriculture collectively<sup>11</sup>
- 4.18 Cost increases of this magnitude would be most unwelcome especially in the current economic climate, so Federated Farmers recommends that the \$25 fixed price surrender option should be maintained.

## **5. ABOUT FEDERATED FARMERS**

- 5.1 Federated Farmers of New Zealand is a member-based organisation representing farming and other rural businesses. Federated Farmers has a long and proud history of representing the needs and interests of New Zealand farmers.
- 5.2 The Federation aims to add value to its members' farming business. Our key strategic outcomes include the need for New Zealand to provide an economic and social environment within which:
- Our members may operate their business in a fair and flexible commercial environment;
  - Our members' families and their staff have access to services essential to the needs of the rural community; and
  - Our members adopt responsible management and environmental practices.

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<sup>9</sup> Draft submissions of the Red Meat Sector and Fonterra to this review shared with Federated Farmers.

<sup>10</sup> This is calculated taking the average consumption of electricity (21,700 kWh electricity, 1,400 litres of petrol and 3,400 litres of diesel multiplied by the increase in costs in Table 2 on page 36 the discussion paper from \$25 to \$50 per tonne).

<sup>11</sup> This applies the average cost per farm by the number of agricultural enterprises (58,000).