OUR BUSINESS

Fonterra is a dairy co-operative owned by around 10,000 New Zealand farmers and their families. Our business is built on a strong and enduring legacy of thousands of innovative and adaptable farmers who have made New Zealand a world leader in the dairy sector.

The dairy sector creates wealth for New Zealand and New Zealanders. The money our farmers are paid for their milk and our Co-operative’s profits remain in New Zealand. Since the creation of our Co-operative in 2001, dairy exports have grown from $6.3b in 2001 to $17.1b in 2018, and the benefits of this have flowed back into regional New Zealand.

Our strong co-operative values drive our business. We pay our farmers the maximum sustainable price or their milk and our transparent milk price calculation is the envy of farmers the world over. Where once, Kiwi dairy farmers were paid approximately half that of their European or US peers, New Zealand farmers are now consistently paid at parity, or more.

With the support of the New Zealand Government, we have a modern and world-leading dairy sector where our products are desired in markets around the globe and where consumers are increasingly prepared to pay a premium for New Zealand products.

The ultimate strength of the New Zealand dairy sector is the ability of our farmers to innovate and adapt to change. Our farmers will continue to lead the world by producing the highest quality milk, adopting technological advances and committing to increasingly enhance and protect their land.

Fonterra supports a dairy industry that promotes investment in regional New Zealand and where profits are kept at home for the benefit of all New Zealanders. We see a healthy environment as the foundation for a strong economy and a sustainable dairy industry.

The unique attributes of New Zealand’s environment must be protected, enhanced and regenerated for generations to come. We will support our farmers, helping them to innovate and adapt to change.

FONTERA’S POSITION

New Zealand must play its part in meeting its obligations and commitments in the global effort to limit average temperature increases to 1.5 degrees Celsius above pre-industrial levels.

New Zealand’s emissions profile is unique. Unlike many other developed countries, nearly half of our greenhouse gas emissions come from the agriculture sector. While most developed nations face the challenge of transitioning industrial processes and moving to renewable energy, we must find a way to manage our animals’ natural emissions while also addressing the use of fossil fuels in transport and manufacturing.

For Fonterra and our farmer owners, this challenge is significant. Our business represents approximately 20% of New Zealand’s gross greenhouse gas emissions. 89% of these emissions come from farms, predominantly from the cows’ biological emissions of methane and nitrous oxide; 10% from the manufacturing process, primarily the use of fossil fuel energy for processing heat; and 1% from our supply chain which distributes our products to markets across the world.

New Zealand’s dairy sector is one of the most carbon efficient in the world and Fonterra’s New Zealand emissions per unit of dairy is approximately one third of the global average. This efficiency has come about through our farmers’ willingness to innovate and adapt; our productive pastoral system and the relative productive life of our livestock.

Fonterra supports action to reduce agricultural emissions and we will support our farmers in the transition to lower their emissions.
We support methane being treated differently than carbon.

We believe that emissions pricing at a farm or processor point of obligation alone will not achieve the level of change needed. Complementary measures, and a significant investment in research and development by industry and Government will be required to support the transition.

New Zealand’s success in achieving significant emissions reductions consistent with our international obligations will require genuine collaborative partnership.

We are committed to working with others and playing a leading role in ensuring the New Zealand dairy industry remains at the forefront of low-emissions food production. We recognise and support the intention of recycling the revenue received from any emissions pricing scheme back into the industry to support emissions reduction, and that this creates opportunities to cooperate.

Fonterra supports and encourages the proactive work that the Government has undertaken with the wider agricultural industry to find the most appropriate and most effective solutions to support on-farm change. The Primary Sector Commitment titled “He Waka Eke Noa – Our Future n Our Hands” creates a pathway to support farmers with the required transition.

RESPONSES

Agricultural climate policy

As a co-operative owned by New Zealand farmers, we take a long-term view for our industry and our country. We support action to reduce agricultural emissions and support our farmers in the transition to a low emissions economy.

Fonterra supports the introduction of the Climate Change Response (Zero Carbon) Amendment Bill because it creates a framework and institutional arrangements that will keep New Zealand on track to mitigate and adapt to climate change.

– We support the split gas approach recognising the differences between the shorter-lived gas of biogenic methane and the longer-lived gases of carbon dioxide and nitrous oxide.
– We support the 2030 target for a 10% biogenic methane reduction, and proposed to the select committee that it should be subject to reviews in line with the development of the first three emissions budgets.
– We support a 2050 methane target that is provisionally set at up to 24% net reduction from 2017. We proposed to the select committee that regular reviews of this target must be based on scientific and economic analysis.
– We support the 2050 net zero target for carbon dioxide and nitrous oxide.

With the proposal that New Zealand sets a split gas target, it is important that climate change policy recognises the different trajectories needed for these different gases. Methane cannot be treated the same as carbon in long term policy settings and can be managed through policy tools such as permanent free allocation to align with legislated targets.

What is the best way to incentivise farmers to reduce on-farm emissions?

New Zealand needs to create a mechanism that incentivises and supports farmers to reduce their emissions.

In Fonterra’s experience, on-farm change is best achieved by clearly outlining what it is expected, and then ensuring that farmers are supported with the provision of one-on-one advice and practical support. Farmers will need the tools, technologies and knowledge to mitigate and offset their on-farm emissions.

Introducing an appropriate pricing mechanism like a levy and a rebate at farm level by 2025 will help incentivise change and create an environment that enables and supports farmers and growers to make proactive changes on their farm and see a direct benefit of that investment.

It is important that the long-term outcomes are clearly established. If farmers are changing their farming systems and investing in new products, they need certainty that the goal is not subject to significant and rapid change. They need to know that the money they are investing will get them the desired result.

It should be noted that the challenge of reducing emissions sits alongside the need to maintain and improve water quality, biosecurity, biodiversity, animal welfare, and financial performance within an integrated farm system.
Emissions pricing alone will not result in the level of change needed on-farm and complementary measures play an important role. For example, significant industry and Government partnerships are required for investment in mitigation innovation, skills development, and infrastructure.

**Do the pros of pricing emissions at farm level outweigh the cons, compared with processor level, for livestock? Why or why not?**

We support pricing emissions at farm level.

Our farmers have consistently told us that, should they be subject to a pricing mechanism, then this mechanism should be set at farm level. New Zealand farmers are predominantly small and medium sized businesses and as such they want to have clarity over the costs associated with their business. A farm level pricing mechanism allows farmers to receive a direct benefit from any emissions reduction mitigations they undertake. The closer the action and benefit are linked, the greater the likelihood of behavioural change.

A processor point of obligation risks defaulting into what could be a blunt price applied across all farmers in a way that does not differentiate unique on-farm performance as all farmers face the same cost per kilogram of milk solid produced despite the variability in their level of emissions.

We recognise that there may be higher administration costs involved in farm level pricing than the processor level pricing option, but, in the scheme of things, these costs are not significant and there are opportunities to minimise these.

**Do the pros of pricing emissions at farm level outweigh the cons, compared with processor level, for fertiliser? Why or why not?**

We support the pricing of nitrous oxide emissions from the use of nitrogenous fertilisers being applied at farm level. Similar to the animal emissions, we believe a farm level pricing mechanism is the most effective way for a farmer to see the direct benefit of their actions.

To reduce the administrative costs of implementing a farm level pricing mechanism, the tool that is created to estimate animal emissions could also estimate fertiliser emissions.

In 2017 Fonterra participated in the Dairy Action for Climate Change programme, where we tested how emissions reporting could be done at scale. We tested an on-farm Greenhouse Gas recording system with 104 farmers and provided farms with a unique Greenhouse Gas report. We believe it is possible to robustly estimate biological emissions for both animal and fertiliser emissions using data that is currently available.

We will provide all Fonterra farmers with a farm-specific report for biological greenhouse gas emissions by the end of the 2019/2020 milk season and are happy to share this work, if that would be useful.

**What are the key building blocks for a workable and effective scheme that prices emissions at farm level?**

In order to be effective and workable, the scheme will need to consider the following elements:

- **Easily understood**

Farmers need to be able to easily understand and interact with the scheme. Farmers need to have confidence that the actions they take on-farm are reflected and rewarded in the scheme, which means that farmer awareness and engagement need to be well embedded within the scheme design.

- **Investment of revenue raised**

We are highly supportive of any measure which recycles any revenues received from a pricing scheme back into the agricultural sector to assist with the development of innovative technologies and innovative strategies to reduce emissions. Farmers need to have a belief that any price scheme implemented will be used to invest and support the agriculture sector to meet their climate change obligations.

- **Adaptability**
To meet future emissions targets, we will need to deploy new technologies. The scheme will need to quickly recognize and reward these new technologies to ensure rapid uptake as soon as they are scientifically proven and commercially available.

- **Incentives**

There should be a direct link between action and consequence. The use of incentives should be investigated to recognise and reward those taking positive steps to reduce their emissions. Any incentive will have to be carefully considered to ensure that the recognition doesn’t encourage any perverse outcomes and incentives should also avoid punishing early movers or reward laggards.

- **Transparency**

There will need to be a high degree of transparency applied to the scheme as the absence of such could lead to significant scepticism amongst farmers. There needs to be transparency in the method of estimating emissions; the relationship between any pricing scheme and the emissions trading scheme price for New Zealand Units; and the way in which any revenue is recycled to ensure that this is invested appropriately.

- **Flexibility**

Operating in a pastoral farming context means that there are invariably variations of emission levels that will occur between seasons which are often outside of a farmers’ control. This is due to differing climatic and agronomic settings which influence on-farm productivity. If a price based system is implemented, then a 3-5 year rolling average should be considered to determine a farm’s emissions profile in order to smooth any seasonal variation that may create unintended consequences.

- **Collaboration**

Collaboration between farmers and Government is critical to establishing trust and buy-in for the scheme. There is significant merit in co-designing a scheme that enables it to be as administratively easy as possible for farmers and Government, whilst also allowing for processors and exporters to be able to leverage off the scheme to look for ways to achieve any value that could be enhanced with specific carbon market claims.

- **International Leakage**

Any potential scheme should avoid creating international leakage whereby carbon efficient New Zealand production is replaced with inefficient international production.

- **Auditability**

The scheme needs to be easily auditable. This includes the collection of relevant on-farm data points required to estimate emissions and the tools used to estimate emissions.

**Other points to consider**

Any price scheme will need to have a very clear relationship between the pricing mechanism, and the method which is used to determine the distribution of free allocation.

A degree of conflict is inevitable when scarce resources are allocated, but an overarching framework that recognises and reduces the tensions between competing interests and provides a consistent framework or process for ensuring equitable decision-making has the potential to reduce that conflict.

New Zealand is simultaneously setting nutrient allocations regionally and nationally, and as such our preferred allocation method would be based upon “Land Use Suitability” framework which would consider land use against environmental, social, cultural and economic values. This framework would ensure that farmers are receiving the land use signals in policy (water and climate) to ensure that land and land use is well matched to meet the environmental, social, cultural and economic values that is desired.
At a principled level, we support an allocation method that supports efficiency but does not create an incentive to increase absolute emissions. Of the options presented in the ICCC Report, we believe that an output-based allocation is the only approach that achieves the desired outcomes.

We note the concerns raised in the ICCC Report, that an output-based approach may encourage some farmers to increase their output. While we note that this is a valid theoretical concern, in practice, the likelihood of being able to significantly increase their output is limited as farmers are subject to other regulatory constraints.

We are concerned that a land based or hybrid approach to allocation would significantly under-allocate units to the dairy sector to the extent that even with 95 per cent allocation to the agriculture industry, the dairy sector would only receive an allocation of 55 per cent to 80 per cent.

This would mean that the sector would have to reduce its emissions by 2025 by the same amount of the agriculture sector as a whole is expected to reduce by 2050. This level of emissions reductions are not possible and would have significant economic impacts for dairy farmers and the broader New Zealand economy.

What should the Government be taking into consideration when choosing between Option 1: pricing emissions at the processor level through the NZ ETS and Option 2: a formal sector-government agreement?

The Government should consider:

• **Transition pathway**

As discussed above, an on-farm approach will drive the most reductions at the cheapest cost in the long run. Therefore the Government should adopt the approach which is most likely to allow for the successful introduction of a farm level approach as quickly as possible.

• **Efficient short-term emission reductions**

Given that this scheme will be in place for five years, it is important that it causes farmers to start to reduce their emissions before an on-farm level approach is introduced. This should happen in the most cost-effective way possible.

• **Collaboration**

Successfully implementing an on-farm approach by 2025 will require strong meaningful collaboration between industry and Government in order to leverage off the strengths of each. An approach that embeds and empowers both Industry and Government to work in cohesively in partnership should be a key consideration.

• **Perception**

If farmers view an approach to be ineffective or simply a revenue raising exercise, they are more likely to resist the approach. As we have stated above, the closer a scheme can link action to benefit, the greater likelihood there is of adoption.

As an interim measure, would Option 1: pricing emissions at the processor level through the NZ ETS with recycling of funds raised back to the sector to incentivise emissions reduction or Option 2: a formal Government-industry agreement for reducing emissions be best? Why?

We believe that the most effective and cost-effective interim measure is Option 2: a formal Government-Industry Agreement for reducing emissions to build the systems and processes required to ensure that emissions reductions can be achieved.

We support the Primary Sector Commitment titled “He Waka Eke Noa – Our Future in Our Hands”. This commitment a significant step forward by the primary sector in seeking innovative and collaborative ways to supports farmers and growers in response to the challenges posed by climate change. The commitment seeks to work in good faith with the Government and Iwi to co-design a practical and cost-effective system for reducing emissions at farm level by 2025. This commitment is supported by a proposed 5-year programme of
action aimed at ensuring farmers and growers are equipped with the knowledge and tools they need to deliver emissions reductions while maintaining profitability.

We believe that *He Waka Eke Noa – Our Future in Our Hands* performs better than a processor based approach on each of the considerations outlined below:

- **Transition pathway**

  The steps outlined in the Primary Sector Commitment set out a pathway that will ensure that the industry is ready for a farm-level approach by 2025.

- **Efficient short-term emission reductions**

  The tangible actions set out in the Primary Sector Commitment, such as providing farmers with information and advice, will allow farmers to make informed decisions and take action to tackle their emissions prior to 2025.

- **Collaboration**

  The Primary Sector Commitment formalizes and builds on existing collaboration between the Government and the Agriculture Industry such as the Biological Emissions Reference Group (BERG). This commitment represents a significant opportunity for both groups to work constructively to ensure that farmers are given the best opportunity to succeed.

- **Adoption**

  As the Primary Sector Commitment is supported by all of the major farming bodies who represent the views of farmers, following this approach increases the willingness of farmers to quickly adopt the scheme.

*What additional steps should we be taking to protect relevant iwi/Māori interests, in line with the Treaty of Waitangi?*

Fonterra recognises that there are some unique challenges bought on by climate change for Iwi/ Māori interests. We recognise that the unique characteristics of Māori land mean that there may be issues with how Māori are, and have been, best able to respond to policy in timely way to maximise the opportunities and minimise the risks associated with these characteristics.

Fonterra supports planning provisions being investigated to ensure that there are no more barriers than are necessary to allow for continued development of Iwi/ Māori landholdings. These provisions may include additional support or investment by Government to ensure that it meets its responsibilities under Te Tiriti o Waitangi.

*What barriers or opportunities are there across the broader agriculture sector for reducing agricultural emissions? What could the Government investigate further?*

There are a number of additional barriers or opportunities that would be suitable of further investigation:

- **Rural Advisory Services**

  There is currently a shortage of suitably qualified and experienced rural advisors to adequately support the sector in ensuring that farmers are given appropriate support to investigate change. The Governmental should consider how to incentivise and encourage education providers to grow the pipeline of young rural professionals to support farmers.

- **Precision Agriculture**

  Fonterra is eager to work with the Government to explore whether there are opportunities to use the audit and estimation systems required for the administration of an on-farm scheme for the purposes of supporting efficiency opportunities. This could include the likes of any satellite imagery for the monitoring and estimation of pasture.
• **Ongoing Research**

Industry and Government should significantly increase agriculture mitigation innovation funding and investigate ways to support research into greenhouse gas reduction. There is a need for solutions that may require different approaches to research investment.

Currently there are too few potential mitigation technologies being researched. Given these technologies are “long shot” technologies, more technologies need to be investigated to increase the probability of success.

The following would be helpful:

– Participation in a seed fund to develop at least 20 ideas globally;
– Further screening facilities to test the most promising ideas as there is currently a bottle neck;
– Global sprints and/or X-Prize to generate ideas;
– Innovative private/public partnership opportunities; and
– Maximising the investment in the Global Research Alliance.

• **On-Farm Carbon Sinks**

In order to ensure that farmers get the most appropriate signals on how best to manage their lands, the Government should investigate how carbon sinks can be recognised. This includes an understanding on the role of soil carbon, sequestration from riparian areas and shelter belts, and the opportunity within blue carbon capture.

• **Integration with wider farming regulation**

The policies that will be developed to support emissions reductions will need to sit comfortably alongside the Resource Management Act, any National Environment Standards or National Policy Statement for freshwater management, regional planning regulations, the Agricultural Compounds and Veterinarian Medicines Act (ACVM) and the sector specific rules (such as the NZCP1: Design and Operation of Farm Dairies).

*Do you agree that the method for free allocation of emissions units at processor level should be output-based? Why or why not?*

We prefer the proposed Primary Sector Commitment, than the introduction of a processor-based pricing mechanism.

There are some actions that we could take to encourage a reduction of emissions amongst our farmers but these actions would need to be monitored and audited on an individual farm level. If systems were in place to allow for this, we do not believe there would be any impediments to moving to an on-farm level approach.

An on-farm level allocation would drive much more change because there are significant differences between the efficiencies of different farms.

If a processor level obligation is introduced, we would rather a pathway for a processor to transfer to an on-farm system early rather than setting up an output-based system.

Fonterra represents ~80% of the dairy sector. As such, our emissions tend to match the national average. Within the Fonterra supply base, there are clearly identifiable regional variations of outputs efficiency. This would mean that when compared against Fonterra, the independent processors will likely have an actual output benchmark that is different to the national average based upon their regional milk collection zones. This would mean that Fonterra will likely never be able to seek a unique emissions factor that will vary from the national average emissions factor, however this framework would enable independent processors to seek a unique allocation factor to change their annual allocation.

We consider this outcome to be negative. There is a risk that this framework will enable independent processors to achieve an advantage simply due to the geophysical characteristics of their milk collection zones, and the risk that this advantage may not ever transfer into a difference from the average in the price passed through to their farmers. Independent processors typically have little incentive to differentiate their milk
price from the Fonterra milk price (as the proxy for a national average), and as such the incentive to differentiate the emissions cost paid to farmers from the national average would also be low.

Should a processor level obligation be introduced, we believe that the proportional allocation method is the most appropriate option for transparency and rationality. As the processor level obligation is only intended as an interim pre 2025 scheme, then a scheme that treats all processors the same, as proportional allocation does, is important.

_Do you agree that free allocation of emissions units should be provided at the same time emissions obligation are due? Why or why not?_

Yes. Receiving the allocation early would allow us greater flexibility but we do not think these benefits will be significant. Therefore, we do not have a strong view about when the allocation should be provided.

_Do you agree with the ICCC that allocation factors should be updated in line with business-as-usual improvements in emissions intensity? Why or why not?_

Yes. We agree that the emissions factors should be updated regularly to ensure on farm emissions reflect actual emissions.

Reducing the free allocation and adjusting the allocation factors need to be considered together because it is the net cost of these changes which will determine the costs our farmers will face.

The most transparent approach is to keep allocation factors constant and to drive reductions through changes in the free allocation percentage. This will mean that this percentage can be directly compared to the Government’s Climate Change Response (Zero Carbon) Amendment Bill targets.

_Do you agree the process for making decisions on any phase down of free allocation of emissions units should be set in legislation and informed by the Climate Change Commission? Why or why not?_

We agree that the allocation of units should be informed by the Climate Change Commission’s assessment of up-to-date science and economic evidence.

We agree that the level and phase down rate of free allocation should be set in legislation.

It is important that the allocation factor, and any allocation factor adjustments, also be set in legislation as decisions on the allocation factor will have a similar impact on the sector.

_ENDS_