

# SUBMISSION

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To: ETS Review 2011 Consultation  
Ministry for the Environment  
P O Box 10362  
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Submission on: Emissions Trading Scheme Review 2011 Issues Statement

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# SUBMISSION TO EMISSIONS TRADING SCHEME REVIEW PANEL ON: EMISSIONS TRADING SCHEME REVIEW 2011 ISSUES STATEMENT

## 1. EXECUTIVE SUMMARY

1.1 Federated Farmers of New Zealand submits that it strongly opposes biological agricultural emissions from food production remaining in the Kyoto Protocol and subsequent international agreements. Federated Farmers, noting the above statement, further considers that should the inclusion of biological agricultural emissions in the emissions trading scheme (ETS) remain, it should be postponed far beyond the entry date of 2015 currently set in the legislation.

1.2 Our preference as an organisation remains that there should be no ETS in New Zealand. If New Zealand must have an ETS, then it must not include biological agricultural emissions. If New Zealand must have an ETS and include biological agricultural emissions, then there are a number of requirements the legislation and regulations would need to satisfy before that could occur.

1.3 Such requirements would include:

- Removal of the legislated entry date of 1 January 2015 for biological agricultural emissions from food production.
- Insertion of conditions on the entry of new sectors to the ETS that include:
  - That competitors in other countries have similar schemes or otherwise face similar emissions costs;
  - That economically-sustainable mitigation technologies are available for widespread uptake; and
  - That international rules allow New Zealand to recognise the uptake of such technologies.
- Retention of transitional measures, such as:
  - The grace period for penalties upon the entry of a sector to the ETS;
  - The one-for-two obligation;
  - The \$25 per tonne price cap;
  - The ability to pay money in lieu of surrendering emissions units to the government; and
  - The ability for the government to issue emissions units where money is paid in lieu of emissions units.

1.4 Federated Farmers is aware of the terms of reference and the matters on which the Panel has sought comment. There are however arguments that the federation has

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included in this document to more fully express the views of New Zealand farmers on the ETS.

## **2. FEDERATED FARMERS POLICY POSITION ON THE KYOTO PROTOCOL**

- 2.1 Federated Farmers opposed the government's 2002 ratification of the Kyoto Protocol and remains opposed to it. Our members are of the strong view that it is unjustifiable and inappropriate for the government to bind New Zealand to emissions reduction commitments and certain economic hardship for little if any environmental benefit. This is even more true today given the current economic climate.
- 2.2 In 2002, the government of the time submitted a National Interest Analysis that outlined their reasons why they considered it in New Zealand's interests to ratify the Kyoto Protocol. The National Interest Analysis however suffered a range of fundamental flaws that the federation considers have caused the series of policy rethinks that saw a special select committee established in 2009 and now a technical review panel to examine whether the current policy regime is appropriate.
- 2.3 Chief among those flaws was the insistence that ratification of the Kyoto Protocol was quite separate from the domestic policy response New Zealand would have to undertake to honour the Protocol's obligations, and the absence of any effort to quantify the environmental benefits of ratification.
- 2.4 Federated Farmers argued then, and continues to argue now, that it is irresponsible for any government to commit to honour treaty obligations without first having a clear idea of how that could be done in a fair and just manner. The resulting policy failures for the agricultural emissions research levy in 2003, the carbon tax in 2005, and now the emissions trading scheme highlight the political problems for blindly taking action.
- 2.5 That the environmental benefits of ratification could not be clearly outlined then and continue to remain largely unknown is an indictment against government process around climate change. Federated Farmers argued that where the environmental benefits of ratification cannot be described, that the government should instead focus on the more easily discernible effects of New Zealand being a party to the Kyoto Protocol. This clearly has not happened with any robustness over the years since New Zealand ratified the Kyoto Protocol.
- 2.6 However, in light of New Zealand's ratification of the Kyoto Protocol, and that there is a domestic policy response, Federated Farmers considers:
  - *The government should not appropriate the carbon rights of landowners.* Landowners created the carbon right through land management decisions and the government should not be able to take or assume a property right without providing fair compensation to affected landowners.
  - *The government should revise its preferred policies to better reflect what our key trading partners and competitors are proposing to do.* Among those countries that have committed to emissions reductions, New Zealand is uniquely reliant on the export earnings of the primary sector. Domestic Kyoto policies will impact adversely on the competitiveness of those exports in offshore markets.

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- *The government should seek to adopt policies that impose least cost, are least distortionary, and will result in efficient resource allocation.* The impacts on the New Zealand economy from constraining carbon through price mechanisms are of a scale that hasn't been seen since the reforms of the 1980s.
  - *Biological agricultural emissions should not be included in an emissions trading scheme, until (a) our major trading partners and competitors take action to reduce such emissions and (b) there are mitigation measures that are economically sustainable and easily implemented by farmers.*
- 2.7 Our members remain highly sceptical of the government's reasons for pursuing compliance with emissions reduction commitments under the Kyoto Protocol. However, efficient farmers have never shirked from making responsible decisions. For example, future proofing their production systems by establishing water storage, development of new crop and pasture cultivars, or adopting any other technologies that enhance their viability in the face of a changing environment.
- 2.8 Federated Farmers is deeply concerned that any climate change policy must demonstrate that it is practical, economically-sustainable and ensure New Zealand farming can remain economically viable and internationally competitive through even the most testing of economic times, such as those being experienced right now.
- 2.9 Looking at the March 2011 issue of NBNZ Rural Focus, there is an item on trade and more specifically the tariffs that New Zealand agriculture are forced to bear as exporters. The overall burden for agricultural exports was in the area of \$1.5bn in 2010. Breaking that down to what that means for pastoral farming, the average beef farmer lost revenue in 2010 of \$15,900 or 19% of profit. For the average dairy farmer, lost revenue in 2010 was \$100,950 or 34% of profit. Not only are New Zealand farmers subsidising overseas governments to a ridiculous extent, but these are costs that our trade competitors would not be facing, certainly not to the extent that we are in New Zealand. Put simply, including biological agricultural emissions in the ETS would only exacerbate the situation of New Zealand farming and build on the range of pressures that already threaten the viability of food production in this country.
- 2.10 The ETS poses its own challenges to the future of farming in New Zealand, challenges most farmers struggle to see how they would remain viable, in producing subsidy-free products and trading to countries with distortionary barriers to trade. Substantial and immediate improvements are required to the current ETS before these challenges can be overcome.

### **3. GENERAL COMMENTS**

#### **3.1 Agriculture Sector Inclusion in the ETS**

- 3.1.1 Farmer opposition to government efforts on climate change policy has been consistent over the years. At the heart of such opposition is an understanding of the farming sector being expected to shoulder a burden that neither makes sense nor leaves this sector and the country as a whole, economically-viable.
- 3.1.2 New Zealand farmers operate in an unsubsidised environment and are viewed internationally as highly efficient. Environmentally, it simply does not make sense to introduce a regime for New Zealand agriculture that forces production to less efficient

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jurisdictions or encourages reductions in efficient production here in New Zealand – again, a lose-lose situation for New Zealand and for the global environment.

- 3.1.3 It is abundantly clear to the federation that the current ETS is unsustainable for New Zealand and on this basis it should not proceed. The economic effect of such a scheme on the farming sector and our country will be difficult for the country to bear against current and on-going economic conditions.
- 3.1.4 Despite farming's huge contribution to the economy and boasting a superior productivity performance, farmers increasingly feel that they are not receiving adequate reward for their efforts. Over recent years there has been an insidious margin squeeze with farmers caught between remorselessly high inflation for their farm inputs and incomes that are at the mercy of fluctuations in commodity prices, the exchange rate and the weather, all of which are beyond the ability of farmers to control.
- 3.1.5 It is important to recognise that farmers are price takers, not price makers. Unlike many businesses, including those that provide services to the agricultural sector, farmers have no easy or direct ability to increase selling prices – they are mostly globally set. This means that when farm input costs rise while incomes remain static (or fall), farmers either have to cut spending or increase debt, with the latter increasingly less of an option due to the heavy indebtedness of many farms and stricter lending criteria being applied by banks.
- 3.1.6 The most recent data from MAF farm monitoring reports shows meagre returns for farmers, even dairy farmers. The table below shows rates of return on equity for the sheep and beef national model and the dairy national model.

**Table 1: Rate of Return on Equity**

|              | 2008/09 | 2009/10 | 2010/11 |
|--------------|---------|---------|---------|
| Sheep & Beef | -0.2%   | -0.2%   | -0.1%   |
| Dairy        | -2.2%   | 3.0%    | 3.4%    |

*Source: Farm Monitoring Review, Ministry of Agriculture and Forestry, October 2010*

- 3.1.7 The rate of return on equity refers to the economic farm surplus (less interest and lease) as a percentage of equity. Income tax, debt repayment, capital expenditure, and living expenses for the farmer's family all have to be met from within this rate of return. Poor rates of return help to explain, in part, why farmers have had to increasingly resort to borrowings, with agricultural debt nearly doubling over the past five years<sup>1</sup>.
- 3.1.8 The impact on farming under the current emissions trading scheme is such that Federated Farmers struggles to see a future for food production in New Zealand and therefore strongly argues for the exclusion of biological agricultural emissions from food production from the ETS, for reasons of:
- New Zealand is the only country attempting to do so;
  - Feeding a growing global population is more important than New Zealand's emissions profile;

<sup>1</sup> Agricultural sector debt grew from \$26.9 billion in November 2005 to \$48.0 billion in November 2010, Reserve Bank of New Zealand *Sector Credit Statistics (C5)*.

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- New Zealand can produce food more efficiently than other producers;
- Without ground breaking new technology, farming cannot reasonably do anything to reduce emissions beyond reducing production;
- The current rules place too much emphasis on reducing temporary non-CO2 gases when carbon dioxide is more persistent;
- The burden of an ETS will put many farmers out of business; and
- The cost to the New Zealand economy being too great for the country to withstand. International product prices are as high as they have ever been, but farm balance sheets are strained because of domestically imposed cost structures.

3.1.9 These are not ideal conditions in which to consider imposing a price of carbon on biological agricultural emissions from food production in New Zealand. We trade so much as a country post-border, and we need to do so more than most. The federation is unable to see how New Zealand can ever hope to compete if costs keep being added without any clarity of benefit. As such, Federated Farmers would argue that the date for the sector's entry must be removed from the Climate Change Response Act 2002.

## **3.2 Realistic mitigation potential**

3.2.1 The likelihood of substantive and meaningful abatement of biological agricultural emissions is somewhat limited and requires time well beyond 2015 before research can be expected to deliver technologies to reduce emissions.

3.2.2 The core issue arises from the complexity of biological systems. The application of a widget to a mechanical process will have relatively easier and more certain effects. The same cannot be said for biological systems as they do not react in the same way as mechanical systems. Using stand-off feed pads as an example, the reduction in nitrous oxide emissions from the collection of dung and urine would be offset by the carbon emissions from the construction of the feed pad and reliance on trucking in supplementary feed.

3.2.3 The potential for biological agricultural emissions to be reduced must be understood on a holistic basis as the application of various practices and technologies targeting one greenhouse gas will have the effect of increasing the emission of other greenhouse gases. The permanence of the mitigation effects of a technology is another reason why more time is required to better understand what happens when farm management changes to attempt to reduce emissions. Other factors affecting the delivery of technologies include:

- Still growing understanding of processes that generate emissions within the New Zealand farming system;
- Challenges in applying yet unproven technologies across widely variable farm types and farming conditions;

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- Uncertainties in the cost-effectiveness of technologies within the New Zealand farming system;
- Uncertainties in the impact that use of technologies could have on other farming pressures such as product quantity, product quality, product consistency, and animal welfare among others.

3.2.4 One also needs to understand the long lead-in times required between the proof of concept and commercialisation stages of product development that complicate an already complicated situation.

### **3.3 International efforts**

3.3.1 New Zealand is the only country to have committed to imposing emissions obligations on the biological agricultural emissions. The EU ETS focuses on heavy industrial emissions and electricity generation. The Japanese ETS is focussed on transport fuel consumption by major companies. The detail of just what Australia and the USA intend to do remains largely unknown, but the previously proposed CPRS looked to exclude agricultural emissions and both the Carbon Farming Initiative and Waxman-Markey sought to reward land managers for various Kyoto non-compliant activities.

3.3.2 New Zealand has in the past adopted a world leader position on addressing biological agricultural emissions ahead of every other party to the Kyoto Protocol. Making matters worse, it has done so while there remain few, if any, options to mitigate those emissions beyond simply reducing production.

3.3.3 For New Zealand food production to remain internationally competitive, the example of other countries must be followed and biological agricultural emissions must remain outside the ETS, while an imbalance exists.

### **3.4 Conditions to entry**

3.4.1 Given the imbalance in applying a price of carbon on New Zealand food producers while competitors avoid such a cost and while cost-effective mitigation options remain largely non-existent, there must be conditions on the entry of biological agricultural emissions into the ETS.

3.4.2 Federated Farmers would consider it reasonable that the review provisions in s160 of the Climate Change Response Act be amended to require that future reviews specifically consider whether New Zealand finds itself such:

- That competitors in other countries have similar schemes or otherwise face similar emissions costs;
- That economically-sustainable mitigation technologies are available for widespread uptake; and
- That international rules allow New Zealand to recognise the uptake of such technologies.

3.4.3 The reason why the federation insists that these conditions must be built into future reviews is to ensure that food production in New Zealand is not forced to bear a price

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of carbon where to do so would make agriculture uncompetitive and largely unable to respond to the carbon price beyond simply reducing production. This is a situation the government should look to avoid.

#### **4. THE SUBMISSION'S APPROACH TO THE ISSUES STATEMENT QUESTIONS**

4.1 The federation is not in a position to comment on all of the questions against which the panel seeks feedback. As such, this submission focuses on those questions that the federation can offer a considered response.

#### **5. SPECIFIC RESPONSE TO QUESTIONS**

5.1 *Q2e: What impacts of the ETS have you experienced to date? Other impacts of the ETS (eg: social, environmental).*

5.1.1 The ETS is having a disturbing impact on land purchase and sale decisions, farm management decisions and planning of on-farm investment often at the expense of the land being put to best use. Since the entry into force of the ETS, the federation has noticed a number of its members have had to revise investment intentions for their farms and farms they've considered purchasing.

5.1.2 This impact has been most visible among members in the Central North Island and Canterbury regions, where land development has been a particularly keen issue. The Central North Island is known for having large areas of pre-1990 forest that has since become excellent farm land with the understanding of how to remedy the mineral deficiencies that saw much of it planted in forests. Canterbury conversely is looking at the development potential that comes from increased irrigation.

5.1.3 That land is now perceived by our members to force somewhat different decisions on its use is having the effect of preventing a lot of land from being put to best use. This has the effect of not only affecting the ability of farm land to realize its full economic potential, but also of encouraging the locking up of land-use more generally. Farmers are under enormous pressure to meet ever-changing market and other drivers of production and any moves to constrain land-use flexibility puts farming at risk.

5.1.4 For an example of the impacts afforestation incentives have on rural areas, the federation would direct the Panel to MAF Policy technical paper 97/3 that looked at the impacts of land-use change in Wairoa District. The executive summary provides a helpful snapshot of rural population decline, falls in sheep and cattle numbers, downflow impact on rural support businesses and affected viability of meat processing capacity, as well as exaggerated environmental effects. Granted this is a snapshot of a particular region suffering under the pressures of the time, but it does highlight the unintended consequences that arise from not looking at the full range of effects of central government policies directed towards affecting land management.

5.2 *Q6f: What impacts do you expect to experience after 2012 (given the current settings of the ETS)? Comparison between carbon prices and abatement costs.*

5.2.1 Carbon prices in New Zealand's ETS are less driven by abatement cost and mitigation potential within our national borders, but more by the value of traded units in the EU ETS. This is not a slight against international linkages (a necessity to ensure highest economic value can be realized by the selling of units, while also enabling international supply of units into the New Zealand ETS to cover off risks to

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liquidity and availability of units to scheme participants), but a nod towards the need for more balance between an ETS designed for New Zealand's interests and a scheme replicating conditions better suited for other countries.

- 5.3 *Q6g: What impacts do you expect to experience after 2012 (given current settings in the ETS)? How you expect the ETS to affect New Zealand socially and environmentally in the long-term.*
- 5.3.1 The effect the ETS is having of confusing and complicating land-management decisions will see New Zealand's productive base progressively less and less optimally managed to deliver the best returns from land being put to best use. Yes, there are additional factors that also affect farm decision-making, and, yes, farm management has to respond to myriad issues and concerns, but the extent to which the ETS makes decision-making so difficult that many are forced to throw their hands up or indeed look to get out of farming altogether, will see social and community impacts on a scale similar to those seen in the 1970s as land conversion to forestry became more widespread.
- 5.4 *Q11: Do the scenarios in table 4.1 capture the most likely outcomes for the international framework after 2012? If not, what other scenario(s) do you suggest the Panel should consider?*
- 5.4.1 It would be worth considering a new scenario 4 whereby a singular international market is instead replaced by an interlinked series of domestic schemes bound by bilateral arrangements.
- 5.4.2 International carbon markets are not maturing or evolving in the way many commentators had originally hoped. The EU ETS functions as a fortress, allowing emissions units in but not out while also being very selective about the units it admits. The New Zealand ETS has taken a somewhat opposite approach. Australia doesn't seem sure where it is heading with its own arrangements except that there will be a low-level carbon charge as well as a heavily under-subscribed and largely non-compliant Carbon Farming Initiative. The USA is unlikely to establish a compliant ETS. The future of Japan's narrow scheme is uncertain given the recent disaster they've suffered.
- 5.4.3 The lessons one can derive from these schemes is that they are all approaching their domestic arrangements in different and unique ways, and it is in their differentness and uniqueness that a promised merging into a cohesive international market is extremely unlikely to eventuate, instead relying on a looser system of bilateral arrangements.
- 5.5 *Q12b: How might the objective(s) of the ETS change under each of these scenarios? In particular: What considerations should influence how the costs of any international obligation New Zealand faces should be shared between different sectors of the economy such as the split between emitters and taxpayers and the relative abilities of different sectors to reduce emissions?*
- 5.5.1 There are two ways of looking at this: fix the target or fix New Zealand's response to the target.
- 5.5.2 In the first instance, conditions can be imposed against New Zealand's agreement to adopt targets under an international framework, a means by which the country can

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hedge its bets while not compromising its participation in the international process in the same way as happened to the USA and Australia during the Bush-Howard years.

- 5.5.3 In the second instance, being realistic about what can be achieved and the relative costs of achievement by different sectors should drive any consideration of how the burden ought to be shared within our national borders.
- 5.6 *Q12c: How might the objective(s) of the ETS change under each of these scenarios? In particular: What is the role of the ETS in preparing New Zealand for the international obligations and other drivers for action it may face in the long-term.?*
- 5.6.1 So long as there remains as much uncertainty around the likely shape and content of future international agreements and rules, it is difficult to see what role the New Zealand ETS could play in preparing scheme participants for what is to come. With that being the case, the more relevant issue to consider is whether ETS settings are optimal for New Zealand's interests and sufficiently flexible to enable the ETS and scheme participants to move with the shifts in international consensus, whether multilateral or bilateral.
- 5.7 *Q12d: How might the objective(s) of the ETS change under each of these scenarios? In particular: Should the ETS design be changed in order to strengthen the incentives for domestic abatement? If so, how?*
- 5.7.1 There are two aspects here: is the ETS adequately recognizing what is happening, and what more could be done to encourage further effort.
- 5.7.2 On the first point, there is a fair amount of unhappiness among landowners that much of their efforts go unrecognized and unrewarded. Efforts include riparian plantings that fail to meet the 30m width threshold, forest plantings that fail to meet the post-1989 threshold and definition as reforestation, and perceived increases in soil carbon sequestration from land management. This understanding is what lies at the core of many of the misgivings many farmers have about the ETS and government efforts to reduce emissions. Whether the fault of international guidelines (separate treatment of sources and sinks in national inventories), international rules (art 3.3 rules around eligibility of forests) or government policy (art 3.4 activities such as soil carbon, point of obligation at the processor-level, etc.), the question of whether the ETS could have a stronger role should be parked until it is first understood why more isn't being done.
- 5.7.3 Put more simply, the ETS should focus on addressing the extent to which it rewards action that is currently being undertaken and the need to incentivize further effort will largely be resolved,
- 5.8 *Q12f: How might the objective(s) of the ETS change under each of these scenarios? In particular: How do you see domestic and international carbon markets developing beyond 2012?*
- 5.8.1 The unlikelihood of achieving a unifying international market means that domestic markets will continue to become more and more focused on serving the needs of scheme participants and national circumstances, than over-arching international ambitions. This is something that New Zealand should look to do with its own ETS settings.

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- 5.9 *Q13a: Under what conditions should the ETS scale up to a full obligation? In particular: Should the fixed price option of \$25 continue beyond the current transition phase (ie, after 2012)?*
- 5.9.1 Yes, it should. While there remains uncertainty over future international agreements and rules, while other countries are still considering how they might respond to their international obligations, while our carbon price remains hostage to the vagaries of action outside our borders, and while our ETS remains out of sync with other schemes, then transitional measures such as the price cap must continue beyond 2012.
- 5.10 *Q13b: Under what conditions should the ETS scale up to a full obligation? In particular: Should the one-for-two obligation continue beyond the current transition phase?*
- 5.10.1 Yes, it should. While there remains uncertainty over future international agreements and rules, while other countries are still considering how they might respond to their international obligations, while our carbon price remains hostage to the vagaries of action outside our borders, and while our ETS remains out of sync with other schemes, then transitional measures such as the two for one obligation must continue beyond 2012.
- 5.11 *Q15: Under what conditions should new sectors enter the scheme and incur surrender obligations?*
- 5.11.1 Only where competitors face a similar price of carbon, where there are economically-sustainable mitigation technologies available for uptake, and where uptake of such technologies can be recognized under international rules, should New Zealand consider the entry of a sector to the ETS.
- 5.12 *Q18: Are there any other issues, in particular any related to the matters set out in section 160(5) of the Act you think the Panel should consider? If so, please provide details of your view.*
- 5.12.1 There are other transitional measures that the review panel would do well to consider retaining with some amendment, namely:
- 5.12.2 S217: the grace period for penalties upon a sector's entry to the ETS should be retained, albeit with a more general period tied to the flexible entry of new sectors, rather than the legislated dates of entry for new sectors.
- 5.12.3 S222C: the payment of money instead of emissions units should be retained to cover risk to scheme participants from low liquidity in the New Zealand ETS and difficulty securing emissions units from other markets to cover shortfalls. If deemed necessary, this measure could be tied to general phase-out conditions for future reviews to consider. Although the rate for cash payments in lieu of emissions units should be tied to the price cap, that the rate is tied to the price cap should be additional incentive to ensure the price cap is set at a reasonable rate.
- 5.12.4 S222D : the ability for the government to issue NZUs where money is paid by scheme participants in lieu of emissions units should be retained as it is necessary where 222C is in effect.

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5.12.5 S222G : the prohibition on the export of emissions units needs to be reviewed as it raises a trade-off between scheme participants realizing the full economic value of emissions reductions vs protecting sovereign risk and managing liquidity concerns. Should those that reduce industrial emissions be prevented from realizing potentially higher values for those reductions? Should those that reduce industrial emissions benefit from a windfall gain under allocation? These are questions that require further thought.

## **6. ABOUT FEDERATED FARMERS OF NEW ZEALAND**

6.1 Federated Farmers welcomes the opportunity to comment on the issues statement for the Emissions Trading Review 2011 consultation.

6.2 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.

6.3 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.

6.4 Federated Farmers has been closely involved in the climate change issue since April 2001, when it was first brought to our attention that agricultural greenhouse gas emissions would be included in the government's domestic policy response to the Kyoto Protocol.

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