

8 February 2019

DIRA Review
Ministry for Primary Industries
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To whom it may concern

Environment Canterbury submission on the DIRA review

This submission follows our earlier letter to the Ministry for Primary Industries (the Ministry) signalling Environment Canterbury's interest in the review of the Dairy Industry Restructuring Act 2001 (DIRA). We are again focusing on the open entry provisions, specifically the requirement for Fonterra to accept milk from new shareholders and to accept any quantity of milk from its shareholders.

As noted in the Ministry's discussion document, the growth of the dairy industry has had considerable economic benefit to New Zealand, including to Canterbury, but this growth has also had negative effects on our environment, through increased greenhouse gas emissions, nitrate leaching, and the expansion of dairy into increasingly marginal land areas. Environment Canterbury is concerned about all three of these issues, and we consider that these effects need to be taken into account in the review. In our view there is a strong case for DIRA to be amended to reduce the influence that DIRA is having, even if only at the margins, on these issues.

Responding to environmental challenges requires aligned policies

New Zealand faces significant environmental challenges, particularly around land use. In Canterbury we know these challenges very well. Responding to them requires a range of targeted policies and tools, such as those delivered nationally and regionally through the Resource Management Act 1991. Notably they include the requirements on regional councils to implement the National Policy Statement for Freshwater Management. Given the significance and magnitude of these requirements it is important to ensure that other policies align with, or at least do not hinder, efforts to address these challenges.

In 2009 the Canterbury Water Management Strategy set long-term targets for Canterbury. Since then we have been working collaboratively with territorial authorities, Ngāi Tahu, industry and community groups towards meeting these targets. In 2012 we imposed strict nitrate discharge limits for the first time, which essentially took the form of not allowing any increase above 2009 – 2013 average nitrate losses. These rules have had a direct impact on the number of dairy conversions. We are now moving towards lower (i.e. tougher) nitrate limits that reflect industry-agreed Good Management Practices, as well as the recommendations of local water management zone committees.

Environment Canterbury agrees with the Ministry's preliminary analysis that the primary driver for the growth of the dairy industry (and subsequent negative effects) appears to be the incentives created by growing international demand for dairy products and associated high prices for commodities. This should not, however, discount the need to examine and address secondary drivers, especially where government may have increased control over these¹. To respond to key environmental challenges, we need to look critically at any policies that unintentionally contribute to negative land use outcomes.

DIRA open entry provisions are likely to influence land use outcomes

Under the DIRA open entry provisions Fonterra is required to accept milk from new shareholders and to accept any quantity of milk from its shareholders. In Environment Canterbury's view, these provisions are likely to influence landowner decision making, at least at the margin, meaning increased cattle numbers and milk production above what would otherwise be the case. If that is not the case, then one might reasonably question whether these provisions now serve any purpose. We appreciate that the initial rationale for these provisions was to counter Fonterra's monopoly. But if these pro-competitive requirements do not still influence land-owner investment decisions then they serve no ongoing purpose. And if they do influence land-owner decisions on matters such as herd size and milk production then it is reasonable to conclude that these same provisions have negative environmental impacts.

Accordingly, we consider that DIRA open entry provisions impact negatively on the dairy industry's environmental performance (and our ability as a regional council to respond to land use challenges such as water quality). We ask that the Ministry work to remove those incentives created through DIRA that conflict with Government goals for a sustainable land-based sector and the outcomes sought through the Government's Essential Freshwater work programme.

The Ministry's discussion document notes that Fonterra can and does influence farmers' milk supply decisions through its price signals. Environment Canterbury can also attest that Fonterra takes its environmental responsibilities seriously and works to address the environmental impact of its shareholder suppliers. But in this respect, it is important to observe that Fonterra lacks the most obvious and straight-forward means of limiting the environmental impact of its shareholders i.e. being able to set or negotiate for agreed contract volumes. This is of course precisely the contractual mechanism that is available to milk purchasers other than Fonterra, such as Synlait and Westland Milk. What stands in the way of this arrangement in Fonterra's case are precisely the so-called "open entry" provisions of DIRA.

For these reasons Environment Canterbury sees merit in the removal of the open entry provisions – at least in the South Island. We note that the original automatic expiry provisions

¹ A comparable examination is usefully being undertaken across the tax system by the Tax Working Group, which has sought to identify 'whether there are areas of our income tax system that unintentionally favour environmentally-damaging activities' (page 50, *Future of Tax Submissions Background Paper*, Tax Working Group, 2018).

were triggered in 2015, when other dairy processors collected more than 20 percent of milk solids in the South Island. The rationale for the 2018 DIRA amendments – that a fuller review be performed before provisions expire in the South Island, may have seemed justified at the time, and we acknowledge that the Commerce Commission found in 2016 that competition was not yet sufficient to warrant the removal of the DIRA provisions. However, the Commission's findings did not consider any environmental impacts of retaining DIRA provisions (being outside the scope of the Commerce Commission's jurisdiction and expertise), and we argue that these should carry weight in future decisions on the open entry provisions. Further to this, we consider there is value in the Ministry testing regional deregulation of the open entry provisions. The Commerce Commission highlighted that this could enable the Ministry to experiment with deregulation before adopting the preferred pathway nationwide. As the region with Fonterra's lowest market share and a relatively competitive farm gate market, and with some of the most pressing land use challenges, removing the open entry provisions in Canterbury alone should be considered by the Ministry.

The Commerce Commission also recommended in 2016 that a staged approach to transition pathways to deregulation was appropriate. Regardless of what changes are made to the open entry provisions, we would like to see an approach to the DIRA review and expiry provisions that provides clarity and certainty. Perpetual reviews create regulatory instability and uncertainty, and constrain the ability for parties, including regulatory agencies like Environment Canterbury, to plan ahead. This too has an adverse impact on the environment.

Thank you for the opportunity to make this submission. For all enquiries please contact Cam Smith, Team Leader Regional Leadership and Policy, 027 429 2739, cam.smith@ecan.govt.nz.

Yours sincerely

A handwritten signature in black ink that reads "Steve Lowndes". The signature is written in a cursive, slightly slanted style.

Steve Lowndes
Chair

CC: Cr David Caygill