



23 February 2012

Animal Sector Team
Sector Policy
Ministry of Agriculture and Forestry
P O Box 2526
WELLINGTON 6140

By email: dairyconsultation@maf.govt.nz

**SUBMISSION on
Proposals to Amend the Dairy Industry Restructuring Act**

1. Introduction

1.1 Thank you for the opportunity to make a submission on the "Proposals to Amend the Dairy Industry Restructuring Act". This submission is from Consumer NZ, New Zealand's leading consumer organisation. It has an acknowledged and respected reputation for independence and fairness as a provider of impartial, and comprehensive consumer information and advice.

Contact: Sue Chetwin
Consumer NZ
Private Bag 6996
Wellington 6141
Phone: 04 384 7963
Email: suzanne@consumer.org.nz

1.2 Our submission focuses primarily on the proposals regarding Fonterra's milk price setting and the key areas for feedback on page 9 of the discussion paper.

2. Proposals on Fonterra's farm gate milk price setting

2.1 Consumer NZ has been very concerned at the high prices being paid by New Zealand consumers for dairy products. The domestic milk market is highly concentrated, dominated by one large supplier and two large supermarket chains. This raises major questions about whether consumers are paying a fair price.

2.2 We support proposals to improve the transparency of Fonterra's milk pricing. Given the lack of normal competitive pressures, transparency in the way prices are set is critically important. A major risk in the current regulatory environment is that Fonterra is able to exploit its market power to inflate prices. If this is occurring, the economic implications for consumers and potential market entrants are substantial.

3. Role of Commerce Commission

3.1 In principle, we support proposals contained in the draft bill to require the Commerce Commission to review Fonterra's milk price manual (clause 150G) and make this review public (clause 150I). We also support proposals to require the Commission to audit the base milk price (clause 150M) and to report on its findings (clause 150O).

3.2 A weakness of the proposals is that the Commission's reports will not be binding on Fonterra. The Commission will also be prevented from stating the amount of the base milk price according to its own calculations (clause 150N(3)). It is also unclear what, if anything, would happen if the Commission's review is unfavourable.

3.3 While the potential for an adverse report may act as a "check" on Fonterra, we believe it is an insufficient control given the cooperative's market dominance. The publication of a base milk price calculated by the Commission has the potential to provide a far greater check. It would also significantly improve transparency, a key aim of the proposed amendments.

3. Milk price principles

3.1 We have some concerns about the assumptions underpinning the milk price principles. The principles are based on the premise that the domestic milk price must be derived from international prices. This is based on the theory that dairy processors in New Zealand, operating in a hypothetical competitive environment, would compete to acquire milk to turn into commodities for export.

3.2 We believe these assumptions need to be explored further in light of the purpose of the Dairy Industry Restructuring Act to promote "the efficient operation of dairy markets *in New Zealand*" (emphasis added). Arguably, the Act envisages a situation where independent processors are able to compete to supply domestic consumers. However, it is not clear how the proposed principles support this objective given they assume competition is primarily to supply global markets.

3.3 In our view, the milk price principles should recognise that an implicit aim of the Act is to provide a degree of protection for domestic consumers. Fonterra's creation resulted from a deliberate decision by the government to establish an entity that could compete in world markets and drive export earnings. However, the government also acknowledged there should be mechanisms to promote the operation of a local market for the benefit of domestic consumers. To date, these mechanisms have been largely ineffective.

3.4 We would like to see further analysis of the milk price principles and an explanation of how they support the purpose of the Act.

4. Raw milk regulations

4.1 We support proposals to increase the total volume of milk available under the Raw Milk Regulations to five percent of Fonterra's total milk supply. We also support limiting access to regulated milk to three seasons, *except* where the milk is being turned into products for domestic sale. In this case, there should be no time limit on supply. We believe this exemption would be consistent with the purpose of the Act to promote a functioning domestic market.

5. Other issues

5.1 While outside the scope of this review, Consumer NZ continues to have concerns about the concentration of the retail milk market, which is dominated by two large supermarket chains. A major risk in such a concentrated market is that the dominant participants can exploit their power to earn higher margins than would otherwise be possible. We believe these factors point to the need for much greater scrutiny of the New Zealand market at all levels.

Thank you for the opportunity to make a submission. If you require any further information, please do not hesitate to contact me.

Yours sincerely

Suzanne Chetwin
Chief Executive