



NEW ZEALAND INSTITUTE FOR THE STUDY
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Structural Reform: the Dairy Industry in New Zealand

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Overview

- Creation of subsidy-free agriculture 1983-2001
- Market (de)regulation: 2001 Dairy Reforms
- Summary of the New Zealand experience



Background to 1984

- New Zealand an economy riven by regulation
 - Forex controls
 - Import controls
 - Subsidies Manufacturing, and agricultural (30% of sales)
 - inducing extra production of unwanted product on otherwise uneconomic land
 - single desk exporting
- New Zealand economy performing badly since 1950
- Impetus for change, and crisis in 1984

1984-2000

- Structural change 1984-1991
 - economy-wide reform
 - elimination of subsidies/tariffs import controls
 - acceptable to interest groups: credibility enhanced by being applicable to all
 - Resource Management Act: focus on effects, not practices in resource decisions
- NZ Agriculture 1991- 2000
 - essentially subsidy free
 - still major control of export environment via producer boards

Effects of Structural Adjustment 1984-2003

- Major decline in farming profitability (especially sheep and beef) 1984-1993:
recovery in the 1990s
- Major change in product mix
e.g. sheep to trees/vines
- Major enhancement in product quality
e.g. 40% less sheep/more higher quality lamb
- Major adjustment away from “uneconomic” use of inputs
e.g. land and fertiliser
- Quite different mix of urban and rural activity
e.g. rural residences coexisting with agriculture
- Portfolios and specialisation
e.g. while the big get bigger- much diversification into tourism and recreation etc. increased focus on the environment

Dairy 1984-2001

All the change that had affected agriculture affected dairy: but issues remained

- a) was engendering excess production from cooperative pricing
- b) retained the single-desk export restriction - restricted entry
- c) the single-desk was becoming dysfunctional

Dairy Board single desk status: market export product (almost all of New Zealand's manufacturing milk)

4 coops owned the Dairy Board two large (95%) two small (5%)
(down from 500 coops in the 1930s)

Ownership/competition duopoly was affecting coordination of marketing and manufacture in foreign markets



Structural Change Options At 2001

1. One large coop buy the other coops out (single desk? insist on investor firms?)
 2. The (2 large) coops merge with the Dairy Board and the single desk be removed
- Option 2 was preferred by farmers and was chosen subject to regulations relating to the dominant position of the merged entity (Fonterra), allocation of quota rights, division/divestment of public and private good activities of the Dairy Board.
 - Fonterra adopted fair-value share pricing that estimates the wholesale price of milk as the residual after the return on processing capital

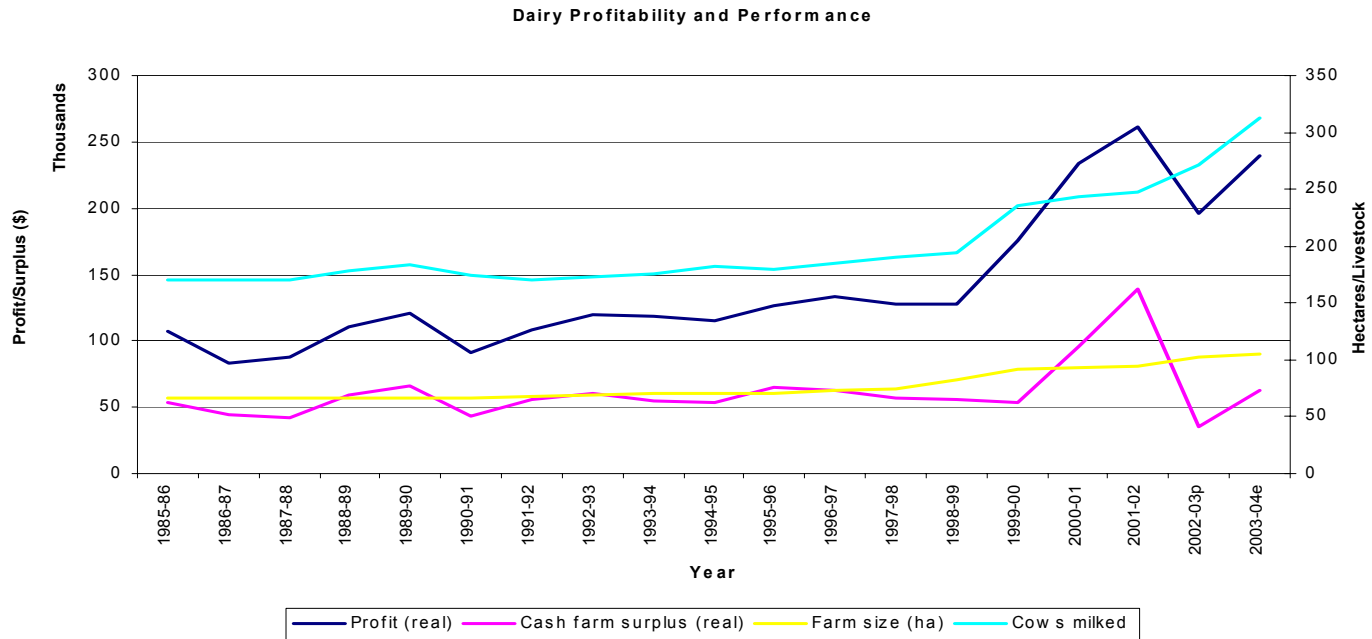
Formation of Fonterra Cooperative Group in 2001

- Fonterra became a dominant cooperative (96% market share)
- Fair-value share pricing and open entry and exit of suppliers, and requirement to supply up to 400m litres disciplines Fonterra in the wholesale raw milk market
- The single desk limitation on competition removed from 2002
- Nature of the change meant that the competition law enforcement institution had to be bypassed to implement the policy



Dairy Performance

There has been some minor entry to date: Fonterra has continued to grow: domestic milk processed and joint ventures



Structure of Fonterra

Cooperative company structure: shares held by suppliers in the proportion to the kgs of milk solids supplied. It has interest bearing listed notes

In addition to its Board, has an elected Shareholders' Council that monitors the company and reports to shareholders. The council appoints the fair-value share (commodity milk price) pricing analyst.

In 2002 it had three divisions

- NZMP collects milk from suppliers and produces 1000 product specifications through a supply chain to 100 countries

- New Zealand Milk: dairy based consumer and food branded products and services

- Fonterra Enterprises: innovation including its biotechnology company

In 2002 produced 7% NZ GDP, the 2nd largest dairy company in the world by volume processed and 4th by sales



Summary: NZ's Dairy Structural Change

- Under the present regulatory structure the ultimate form of the dairy industry will depend upon the forces of the product, service, ownership labour and capital markets. There is no reason to intervene in this process. There remains some debate about the cooperative form and it is being tested
- The approach to de-regulation in 2001 allowed an orderly transition to a de-regulated environment. The alternatives would have
 - caused performance-affecting conflict
 - placed at risk the clean deregulation of exporting, and thereby entry
- The New Zealand experience of structural change, where it is deregulation, is that it has produced flexible agriculture, and an improved allocation of resources. The removal of subsidies in agriculture has been an important part of this.