

SUBMISSION

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Submission on: **Inquiry into the Price of Milk**

From: **Federated Farmers of New Zealand**

Date: 13 September 2011

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SUBMISSION TO THE COMMERCE SELECT COMMITTEE INQUIRY INTO THE PRICE OF MILK

1. INTRODUCTION

- 1.1 Federated Farmers welcomes the opportunity to submit to the Commerce Select Committee's inquiry into the price of milk.
- 1.2 Federated Farmers acknowledges that there has been significant interest in the price of milk. This interest has come from members of the public concerned about the retail price of milk and from independent processors concerned about the price they have to pay Fonterra for raw milk.
- 1.3 Federated Farmers view is that this inquiry is unnecessary at this stage given the work that the Ministry of Agriculture and Forestry (MAF), Ministry of Economic Development and The Treasury are undertaking.
- 1.4 Despite the public concern, the retail price of milk has not increased by more than many other foods or indeed, many other non-food items in the consumer price index. Meanwhile, the issue of raw milk pricing is currently subject to officials' reviews into the Raw Milk Regulations and Fonterra's farm-gate price (see 1.3 above). The Commerce Commission has also considered whether to undertake a full pricing inquiry and found that such an inquiry was 'not warranted'. The Commission noted, *"It is questionable whether Fonterra has scope to exercise substantial market power in relation to the supply of raw milk to other processors. The [Raw Milk] Regulations provide an access regime for raw milk and are designed to counter Fonterra's market power"*.
- 1.5 While the Federation does not agree that this inquiry is necessary we consider it important that farmers have their say in the debate on milk pricing so we are keen to engage with the Committee.
- 1.6 Federated Farmers would appreciate the opportunity to present its submission to the Select Committee.

2. RECOMMENDATION

- 2.1 Federated Farmers recommends that the inquiry find New Zealanders are not paying too much for milk relative to other countries and that the market is operating effectively.

3. COMMENT ON TERMS OF REFERENCE

- 3.1 According to a media statement dated 16 August 2011, "The overarching question for the Select Committee is whether New Zealanders are paying too much for milk and whether the market is operating effectively at all levels". Specifically the Committee will:
 - Consider the various pricing points for milk from the farm-gate to the retail level and to report on any practices that may have the effect on inflating the price of milk for the New Zealand consumer and discouraging efficient competition in the sector;

- Consider what impact and influence the practices of retailers and wholesalers have on the price that consumers pay for milk;
 - Consider the impact of international market prices for milk on each of the pricing points and what other factors influence the price that consumers pay for milk; and
 - Consider whether the current regulatory framework across the milk market is adequate to promote efficient domestic competition and what steps, if any, could be taken to improve the regulatory framework.
- 3.2 The terms of reference is broad and it covers a wider range of very complex issues and interplays. Much of the ground has already been covered by the Commerce Commission’s consideration of whether to initiate a Commerce Act Part 4 inquiry into milk prices, which reported in August that such an inquiry was ‘not warranted’.
- 3.3 The media statement also makes it clear that the inquiry would “work in with the existing interdepartmental investigation into milk price matters” and that it “will not duplicate the work of this investigation”. We agree that it is important for this inquiry to ‘work-in’ with the officials’ review and that it shouldn’t duplicate their work. However, given the interplays between the raw milk regulations and the ultimate retail price we can only observe that this ambition will be a challenge.
- 3.4 The Federation notes that some media focused on page four in the Commerce Commission’s report, *“There appears to be little or no competition, and little or no likelihood of a substantial increase in competition, in what is called factory gate supply”*. What the same media omitted to quote from is the following paragraph that clarifies that observation with *“it is questionable whether Fonterra has scope to exercise substantial market power in relation to the supply of raw milk to other processors. The [Raw Milk] Regulations provide an access regime for raw milk and are designed to counter Fonterra’s market power”*.

4. ARE NEW ZEALANDERS PAYING TOO MUCH FOR MILK?

- 4.1 This is the overarching question for the Select Committee and it is useful to answer this question before embarking on the more detailed discussion of the operation of the milk market.
- 4.2 The main prompt for this question has been stories from Australia where milk has on occasions been sold much cheaper than in New Zealand. It has also been fueled by general concerns about the increasing cost of living, which are much wider than milk, and debate about the price of ‘healthy’ versus ‘unhealthy’ food and beverages.

International Comparisons

- 4.3 Federated Farmers recently investigated the price of milk in several countries New Zealanders like to compare themselves with. Table 1 below shows the resulting international comparisons.

Table 1: International Comparisons of Milk Prices ('Blue Top')

Country	Date	Local Price	NZ Price	NZ Price (inc. 15% GST)	Notes
New Zealand	June 2011	NZ\$2.19 per litre	NZ\$2.19 per litre	NZ\$2.19 per litre	Woolworths on-line. Dairy Dale (2 litre) selling for \$2.90-\$3.20. The appreciation of the NZ Dollar has also had an effect.
Australia	February 2011	A\$1.25 per litre	NZ\$1.60 per litre	NZ\$1.84 per litre	Supermarket war. No GST on milk in Australia.
United Kingdom	June 2011	£0.82 per litre equivalent	NZ\$1.68 per litre equivalent	NZ\$1.93 per litre	Supermarket war. No VAT on milk in UK. UK dairy farmers received £530 million in subsidies in 2009/10.
Ireland	May 2011	€1.10 per litre	NZ\$1.93 per litre	NZ\$2.22 per litre	No VAT on milk in Ireland. Irish dairy farmers received €405 million in subsidies in 2009.
United States	June 2011	US\$1.59 per litre equivalent	NZ\$2.05 per litre equivalent	NZ\$2.25 per litre equivalent	Most US states don't have sales tax on milk. US dairy farmers receive US\$1.1 billion in subsidies per annum.
France	June 2011	€1.26 per litre	NZ\$2.21 per litre	NZ\$2.42 per litre	TVA of 5.5% applies to milk. French farmers (dairy and non-dairy) receive €9.9 billion in subsidies.
Canada	June 2011	C\$2.27 per litre	NZ\$2.93 per litre	NZ\$3.37 per litre	No sales tax on milk in Canada. Canadian dairy farmers receive C\$3.36 billion in subsidies.

Source: See Appendix for information on source material.

- 4.4 On the face of it milk appears to have been more expensive in New Zealand but there are important countervailing factors.
- 4.5 The equivalent to our GST in many of the countries above do not apply to milk, or apply, in the case in France, at a lower rate. Including New Zealand's 15 percent GST aligns prices much closer to New Zealand's and in the case of Ireland, United States and France, higher than the prevailing price of milk in New Zealand. Federated Farmers would not support removing GST from milk or other food items. New Zealand's GST is a very efficient tax because it applies broadly across the economy with very few exemptions. Exempting items from GST would add complexity and cost to the tax system.
- 4.6 Another important factor is that, with the exception of Australia, farmers in these countries are subsidised, meaning that consumers are actually paying more for milk, albeit indirectly through their taxes. Federated Farmers would not support the introduction of subsidies in New Zealand. Subsidies are expensive, they distort markets, and they would be wholly inconsistent with New Zealand's advocacy for trade liberalisation. In this respect, it is worthwhile the Committee reviewing the 7 September 2011 Communiqué of the Cairns Group Farm Leaders¹.
- 4.7 It also is important to observe that Australia's very low price was influenced by the Coles supermarket using milk as a 'loss-leader' in a supermarket price war. This is a

¹ See: http://www.fedfarm.org.nz/f3143,121379/121379_CGFL_Saskatoon_Communique.pdf

copy of an ASDA initiated 'milk price war' in the United Kingdom, a war that continues today. Prior to Coles' February 2011 price cut, the 1 litre price of milk in Canberra was A\$1.97 or around \$NZ2.52 – more expensive than New Zealand even before considering the issue of GST.

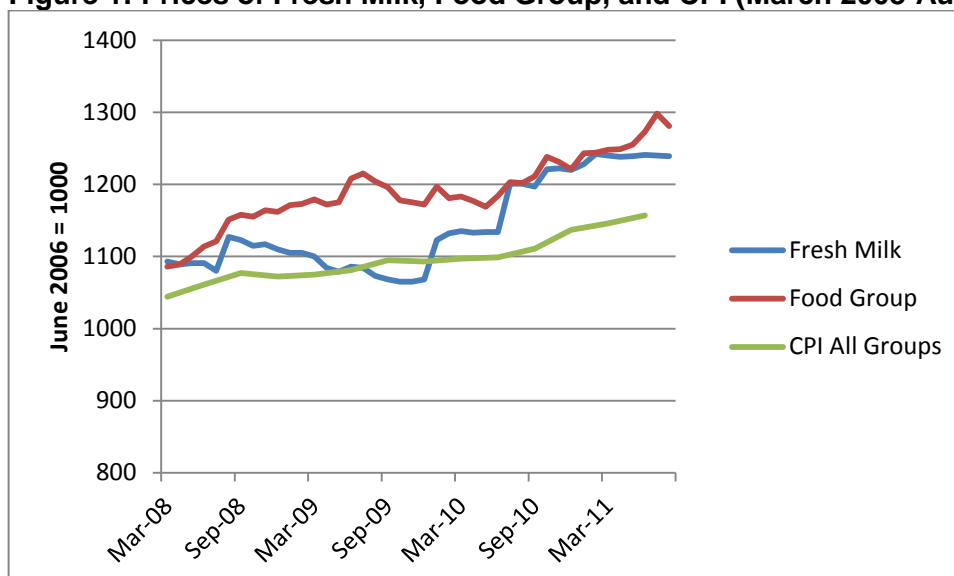
4.8 Finally, it is wise for consumers to shop around for lower priced milk. The price of milk in dairies and convenience stores can often be considerably lower than prices on offer in supermarkets. Dairy Dale, for instance, has been retailing two litre containers at well below \$3 in places like Ashburton and Mt Wellington in Auckland.

Cost of Living Increases

4.9 There has been widespread public concern about the increasing cost of living and milk has been singled out for particular attention. According to Statistics New Zealand's Consumer Price Index (CPI), the overall CPI increased by 15.7 percent over the five years from June 2006 to June 2011². Over that period, the Food group increased by 27.3 percent and within that group 'fresh milk' increased by 24.1 percent³.

4.10 The CPI is published quarterly but the Food Price Index is published monthly. Since June, the Food Group increased by a further 2.0 percent in July but fell 1.3 percent in August, while the price of Fresh Milk (a sub-component of the Food Group) was static in both months. Recent movements in the CPI, the Food Group, and Fresh Milk are shown in figure 1 below.

Figure 1: Prices of Fresh Milk, Food Group, and CPI (March 2008-August 2011)



Sources: Statistics NZ Food Price Index, Statistics NZ Consumer Price Index

4.11 The price of milk has increased by more than the overall CPI but the increase is less than that of the wider Food Group. Meanwhile, a number of other sub-components of the CPI have experienced larger increases, for example:

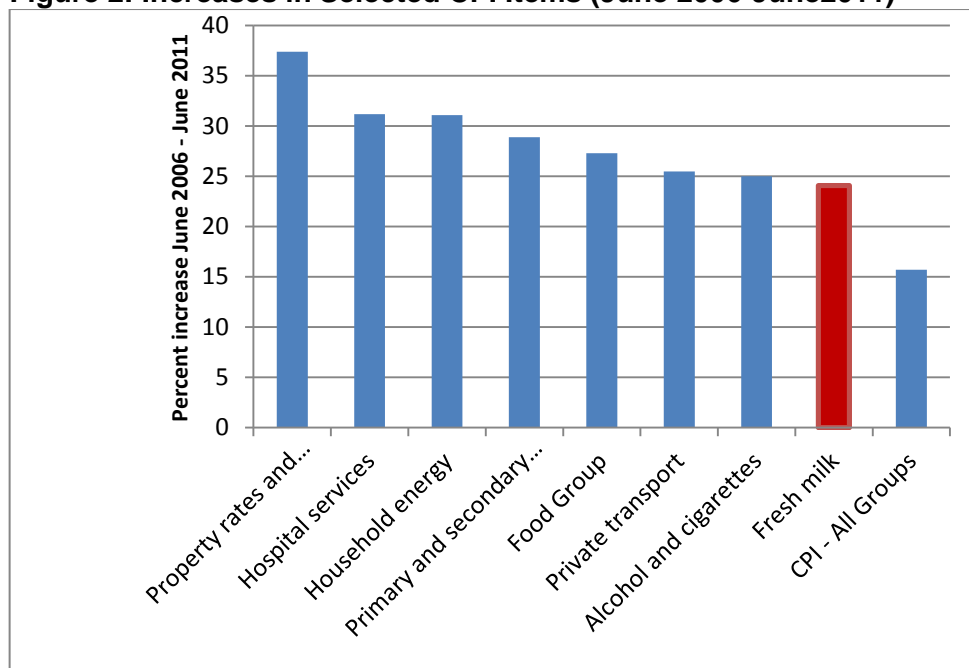
- Property rates and related services: up 37.4 percent.
- Hospital services: up 31.2 percent.
- Household energy: up 31.1 percent.
- Primary and secondary education: up 28.9 percent.

² Consumer Price Index, Statistics New Zealand

³ Food Price Index, Statistics New Zealand

- Private transport: up 25.5 percent.
- Alcohol and cigarettes: up 25.0 percent.

Figure 2: Increases in Selected CPI Items (June 2006-June 2011)



Sources: Statistics NZ Food Price Index, Statistics NZ Consumer Price Index

- 4.12 Federated Farmers is sympathetic to concerns about the cost of living. Farmers are consumers like every other New Zealander. In fact, it may surprise the Committee to learn that many dairy farmers buy their milk at supermarkets and dairies. Raw milk tastes different to processed milk and is of course, full-cream. On top of this, farmers generally have faced large increases in the price of farm inputs, which over the past five years have increased by more than the CPI⁴. However, what is less understandable to farmers is that attention has fallen so readily on milk when many other consumer staples have increased by more over the past five years.
- 4.13 It is also important to look at long-term trends. As mentioned above, the 2000's have seen food prices in most countries increase by more than the rates of inflation. But what is less recognised is that taking a longer perspective, many food staples are cheaper in real terms as shown in Table 2 below. In 2009, milk was cheaper in real terms than in 1999 and 1989 but more expensive prior to then, due to milk being heavily subsidised until the mid-1980s.

Table 2: Real Food Prices 1959-2009 (2009 Prices)

Year	Milk (2 Litre)	Bread (White, 700g)	Apples (1 kg)	Eggs (Dozen)	Sausages (1 kg)
1959	\$2.63	\$1.06	\$3.85	\$10.14	\$7.78
1969	\$2.04	\$1.53	\$5.45	\$8.39	\$7.10
1979	\$1.75	\$1.94	\$3.98	\$5.77	\$7.74
1989	\$3.43	\$2.31	\$3.78	\$4.03	\$6.17
1999	\$3.84	\$2.33	\$3.25	\$3.72	\$6.02
2009	\$3.29	\$1.74	\$3.09	\$3.55	\$7.03

Source: 'Fifty Years of Food', Statistics NZ, 2009

⁴ For example, Statistics New Zealand's Farm Expenses Price Index shows that input prices for 'all farmers' increased by 18.3 percent over the five years to March 2011.

- 4.14 Food also comprises a much smaller proportion of household expenditure. In 1965, 30 percent of New Zealanders' household spending was on food compared to around 18 percent today. The proportion has been relatively stable over the past twenty years⁵. New Zealanders' spending on food is similar to other countries with similar incomes.
- 4.15 Moreover, the reduction of household spending for food has been absorbed by other activities. Federated Farmers does not need to remind the Select Committee that the majority of attendees at the Rugby World Cup will be New Zealanders. The advent of subscriber television, the internet and mobile telephony are but three examples of how the consumer dollar is being spent elsewhere.

Healthy versus Unhealthy Food and Beverages

- 4.16 A common complaint is that healthy food and beverages are often more expensive than unhealthy food and beverages. The relative prices of fresh milk and soft drink are often used as an example.
- 4.17 It should be no surprise that the price of fresh milk is higher than soft drinks. Soft drinks are often little more than carbonated water infused with sugar and food colouring, with virtually no nutritional value. In other words, it is a relatively cheap product to produce and one in which packaging may in fact be more expensive than the contents. In comparison, milk is one of the most complete and versatile foods available so it should be a more valuable product. Milk is also costly to produce and there is a lot of effort both inside and outside the farm-gate that goes into every glass of milk.
- 4.18 Milk has considerable health benefits and some argue that the retail price of milk should be controlled or subsidised to make it more affordable and encourage people to drink more milk. While supporting targeted initiatives, such as the KickStart breakfast initiative run by Fonterra and Sanitarium, Federated Farmers does not believe that the retail price of milk is unreasonably high and in need of government intervention.
- 4.19 In summary, Federated Farmers' answer to the question of whether New Zealanders are paying too much for milk is a simple 'no'.**
- 4.20 The remainder of this submission addresses the four specific areas to be considered by this inquiry.

5. MILK PRICING POINTS

- 5.1 Before discussing milk pricing points, it is important to remind members of the Committee of the structure of the dairy industry.

Industry Structure

- 5.2 In 2009/10 the New Zealand dairy industry had 11,691 herds, an average herd size of 376 cows, total production of 1.4 billion kilograms of milk solids (kgMS) or 16.5

⁵ *Fifty Years of Food*, Statistics NZ, 2009

billion litres of milk. 95 percent of raw milk supplied in New Zealand was processed for the export market⁶.

- 5.3 Farmers are paid for the milk they supply on the basis of cents per kgMS. Fonterra is by far the largest processor of milk in New Zealand. It is the price setter because the farm-gate milk price is based on Fonterra's milk price, regardless of the processor.
- 5.4 Fonterra is a cooperative owned by its shareholder suppliers. Although it is the largest milk processor in the world, Fonterra is not a giant anonymous conglomerate, but a collective of approximately 11,000 mainly small businesses each employing fewer than two people on average.
- 5.5 Cooperatives are widely used in agriculture throughout the world. Cooperatives maximise the benefits to members and collectivise the risks associated with farming. They also collectivise the costs associated with expanding the business. Importantly, the profits from a cooperative feed back into rural communities through the pay-outs made to farmers.
- 5.6 On the other hand, the objective of the conventional investor-owned company is to maximise returns for the owners of the company. There is a constant tension between the price of the raw good and profit returned to the owners of the company. These companies will try to minimise the farm-gate price regardless of the price the product is sold for, so maximising the profit. Dividends are paid to the investor-owners, few of whom are likely to be in New Zealand let alone rural New Zealand.
- 5.7 Cooperatives are particularly important in the dairy industry. Dairy farmers deal with a highly perishable good. They need surety that their milk will be collected every day and there have been occasions overseas when a processing company has used its power to withhold collection to ratchet down milk prices leaving farmers little choice but to accept the lower price or have their perishable product spoil. Farmer ownership and control over processing helps to avoid this problem and the cooperative structure reflects this need for ownership and control.
- 5.8 In 2009/10 Fonterra collected 89 percent of New Zealand's raw milk, with the remainder collected by the following smaller players:
 - Tatua Cooperative Dairy Company Ltd: 0.8 percent.
 - Westland Cooperative Dairy Company Ltd: 3.2 percent
 - Open Country Dairy Ltd: 4.1 percent.
 - Synlait Milk Ltd: 1.5 percent.
 - New Zealand Dairies Ltd: 0.8 percent
 - Other: 0.2 percent.
- 5.9 It is important to understand that Fonterra is the result of many years of consolidation in the dairy industry. When the New Zealand Dairy Board was formed in 1961 there were 168 exporting dairy companies and dairy farmers were struggling to remain economic. By 1995 there were thirteen companies and over the following few years there was further consolidation until the formation of Fonterra in 2001.
- 5.10 The creation of Fonterra was facilitated by government because it saw wider economic benefits from a consolidated dairy industry. The 144 percent growth of dairy exports in the decade 2000-10 (from \$4.6 billion in 2000 to \$11.2 billion in 2010) and its positive impact on GDP, employment, and tax revenues might have happened without Fonterra but, in Federated Farmers' opinion, this is unlikely.

⁶ 2009/10 New Zealand Dairy Statistics , Livestock Improvement Corporation.

Meanwhile, from the perspective of dairy farmers, Fonterra has been beneficial as it resulted in the dairy industry avoiding the fragmentation of the meat industry, which has been one of the factors behind poor profitability for sheep and beef farmers.

- 5.11 The New Zealand dairy industry exports 95 percent of its production, with less than five percent consumed domestically. This is very different to other countries where milk is generally produced for the domestic market at a lower farm-gate milk price. In Australia, domestic consumption trends towards 60 percent and is dominated by two foreign players; Parmalat of Italy and National Foods of Japan. In other countries, subsidies are used by governments to keep inefficient or unviable dairy farmers viable. Ultimately, the consumer pays twice over: at the supermarket and in taxes.

Milk Price Points

- 5.12 The price points for milk are as follows:

- Farm-gate price. This is the price paid by the processor to its suppliers. Fonterra sets the farm-gate price using a Milk Price Manual that calculates the price a notional efficient milk export business within Fonterra would pay its suppliers. The Commerce Commission's August 2011 report explains this well⁷.
- Factory-gate price. Factory-gate supply of raw milk is supply that is not purchased directly from farmers. Instead, it is purchased from another processor who has collected it from farms. Most of this supply comes from Fonterra and most of Fonterra's sales at the factory-gate are made under the Raw Milk Regulations. Under these regulations it has to supply 600 million litres each season to independent processors at a regulated price. This is 3.6 percent of New Zealand's total milk production in 2009/10. Goodman Fielder receives 250 million litres per season while other independent processors are limited to 50 million litres. The default milk price is the farm-gate milk price plus \$0.10 per kgMS. Many Fonterra suppliers feel aggrieved because regulated milk uptake is highest at the 'shoulder' ends of the season when overall milk volumes are low or tailing off. The \$0.10 per kg/MS 'premium' does not reflect anywhere near the opportunity cost.
- Suppliers of town milk: Milk sold for fresh consumption is commonly known as 'town milk'. There are two main suppliers of town milk, Goodman Fielder New Zealand Ltd and Fonterra Brands Ltd. Both supply fresh milk under their own brands. The two supermarket chains also contract town milk processors to process 'private label' milk for sale under house brands. There are also a few smaller town milk providers.
- Retail supply: Milk is supplied to domestic consumers by supermarkets and other retailers like dairies, convenience stores, petrol stations, produce shops, small grocers, etc. However, most milk is sold by supermarkets, with most sold by the two main supermarket chains, Foodstuffs (NZ) Ltd and Progressive Enterprises Ltd.

Comment on Price Points

- 5.13 As mentioned above, the farm-gate milk price is set by Fonterra and is based on a manual which takes account of a number of factors, including world markets. There

⁷ *Milk Markets, Consideration of Whether to Initiate a Commerce Act Part 4 Inquiry into Milk Prices*, Commerce Commission, August 2011.

has been much speculation from both the industry and the wider community on whether this process is sufficiently transparent and results in a 'fair' price. There are claims, for example, that Fonterra is not putting enough into its dividend and thus driving up the milk price. Federated Farmers believes that the process, including the methodology for determining milk price vs. dividend, is transparent and that the resulting milk price is fair. However, we submit that clarification of these issues is needed to assure farmers and others that the resulting milk price is indeed fair.

- 5.14 The farm-gate milk price is very important for dairy farmers as it is their main source of income: over 90 percent according to MAF Farm Monitor reports. If the farm-gate milk price were too high, it would be reflected in high farm profitability. Although dairy farmers had been generally profitable over the past decade, this would be expected given high world commodity prices. However, the National Dairy Model recorded a loss in the 2008/09 season when commodity prices crashed and MAF statistics show that even in the very best years the Model's economic surplus as a percentage of total farm assets has not exceeded 7.5 percent⁸. This would not indicate excessively high profitability or dairy farmers 'milking' consumers.
- 5.15 The farm-gate milk price is used in a number of calculations affecting the wider dairy industry, most notably the factory-gate milk price.
- 5.16 The factory-gate price is set by the Raw Milk Regulations. The regulations spell out the competition policy used to allow for enough competition at the farm gate and the factory gate and to ensure that new independent milk processors have enough certainty to gain a viable foothold in the domestic dairy industry. The regulations are currently being reviewed and Federated Farmers has submitted separately on them.
- 5.17 There are a number of independent processors who subscribe to this milk. Goodman Fielder is allocated 250 million litres and while it uses most to provide competition in the domestic liquid milk market, it is also exporting some offshore as product. Most of the other independent processors who take this regulated milk supply very little to the domestic liquid milk market.
- 5.18 This high degree of exporting shows that there are more gains to be had by exporting than there is by selling domestically. This perhaps indicates that the domestic market has an oversupply, or that prices gained in New Zealand are too low to cover the costs or finally, that more profits can be made by exporting.
- 5.19 Alternatively, some have suggested that the shift of dairy product offshore could indicate the price paid via the Raw Milk Regulations is too high; requiring independent processors to export it in order to make a profit. The Federation doubts that this is the case. Some of those processors possess their own supply but are choosing to sell their milk offshore as well. Businesses choose the more profitable places to market into.
- 5.20 Furthermore, if the regulated milk price were 'too high' it would make sense for independent processors to collect milk directly from farmers. The fact that this is not widespread indicates that it makes greater economic sense (in other words it is cheaper) for them to purchase it from Fonterra at the regulated price.
- 5.21 Federated Farmers considers it unfair to consider making Fonterra responsible for the actions of these other processors. Fonterra supplies the milk at the regulated

⁸ MAF Farm Monitor Reports, National Dairy Model

price and it is up to other businesses to use the milk as they see fit. The current regulations allow for this.

- 5.22 The other main use of the farm-gate milk price is for 'trading among farmers' (TAF). The result of Fonterra's capital restructure has seen the emergence of TAF, where farmers will be able to trade shares amongst themselves. Fonterra's returns to its supplier-shareholders come as a bundle made up of the farm gate milk price and a dividend, totalling the share price. Under the proposal, non-supplying investors will be able to buy the dividend portion of the share from farmers.
- 5.23 Tying the milk price to the dividend to make a whole share means that they are interdependent on each other. Any problems with this, if they exist, are compounded by the fact that currently Fonterra has a fixed share price in order to compensate for having a closed market in which to trade shares. It is therefore critical that the milk price is set transparently and using realistic inputs to allow for complete farmer/investor confidence. Neither would want a portion of the share to be changed artificially.
- 5.24 Dairy farmers are likely to be pleased if this inquiry finds that the farm-gate price is appropriate. If, however, the inquiry finds that changes are required, then Federated Farmers would welcome the opportunity to consider them. All farmers need to know that they are getting a fair price for the milk and all will welcome transparency.

6. RETAILER AND WHOLESALER PRACTICES

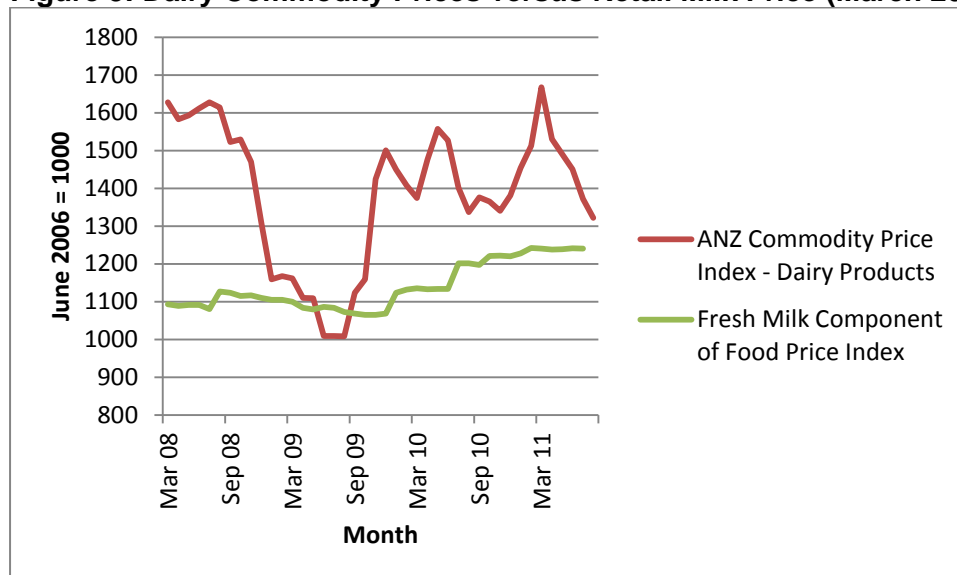
- 6.1 The retail milk price reflects the factory-gate price but only to an extent. The contract that Goodman Fielder has with Fonterra under the Raw Milk Regulations is to supply the domestic liquid milk consumer market. This is discussed in the Commerce Commission report.
- 6.2 However, as discussed above, many processors who take this milk choose not to supply the local consumer market and very few supply it with liquid milk. Federated Farmers submits that it is not Fonterra's fault if independent processors choose not to supply the domestic market given that some of Fonterra's brands are among the more expensive. There exists room for others to come in and undercut the cooperative and make a profit.
- 6.3 Federated Farmers submits that businesses, including Fonterra, should be free to carry out their business in the most efficient manner that maximises profitability and if New Zealand can profit from dairy processors selling their products overseas, then this is good for all New Zealanders. It is not appropriate to ask Fonterra and its farmers to carry the opportunity costs of selling on the domestic market.
- 6.4 Much has been said about the rising price of milk. This is a victory for perception over reality for, as noted earlier in this submission, the Food Price Index shows that the price of all food, with few exceptions, has risen. The same can be said for inflation generally. Federated Farmers is well aware of the effects the supermarket price war is having in Australia. We feel that Australian consumers will not win in the end as low milk prices feed back to the farm gate while the cost of actual farming continues to increase. These low milk prices run the risk of forcing dairy farmers either out of farming or switching supply to a more lucrative export market. Either way in the long run, the total volume of milk produced for domestic consumption will fall.

- 6.5 In February 2011, Fonterra announced that, in light of rising prices, it would hold prices artificially until the end of this year. While Federated Farmers does not support this policy because it distorts reality, we accept that a promise to hold prices should stand, provided it flows in both directions.
- 6.6 Consumers are asking Fonterra to drop the price of milk. Over the years, milk prices have risen and fallen due to market forces; in 2009 the price of fresh milk as measured by the Food Price Index fell almost four percent. In the future, we would expect these rises and falls to continue, but if the milk price is to be cut without reference to the marketplace, who should pay for such a cut?

7. IMPACT OF INTERNATIONAL MARKET PRICES

- 7.1 International market prices are a key determinant of the farm-gate milk price and in turn, the factory-gate milk price and ultimately the retail milk price. This is particularly so when New Zealand exports 95 percent of its milk production.
- 7.2 Since June 2006, the ANZ Commodity Price Index for dairy products has increased by 32.2 percent in New Zealand Dollar terms. This compares to a 23.9 percent increase of the price of fresh milk, as measured by the Statistics New Zealand Food Price Index.
- 7.3 The table below shows that the retail price of milk has tended to be more stable than the commodity price. It is notable that over recent years, New Zealand consumers have been shielded from what have been large increases in commodity prices, even after the high exchange rate has taken off the peaks off the world prices. However, over time it appears the prices do converge.

Figure 3: Dairy Commodity Prices versus Retail Milk Price (March 2008-July 2011)



Sources: ANZ Commodity Price Index, Statistics NZ Food Price Index

8. REGULATORY FRAMEWORK

- 8.1 The dairy industry is regulated by the Dairy Industry Restructuring Act 2001 (DIRA). DIRA seeks to promote contestability in New Zealand markets for dairy goods and services. DIRA allows for regulations to require Fonterra to supply raw milk,

components of milk, and products derived from milk and regulations to specify the price or pricing methodology to apply as well as other terms of supply.

- 8.2 Federated Farmers has submitted on a number of consultations pertaining to the DIRA and associated Raw Milk Regulations, most recently on 2 September 2011 to MAF's Review of the Raw Milk Regulations. The Act was amended in 2010 and the regulations amended in 2007, 2008, 2009, and 2010. This constant revision is regarded by many dairy farmers as an unwelcome distraction to their core business of producing high quality milk.
- 8.3 That said, in our latest submission, Federated Farmers has agreed that the Raw Milk Regulations need to be updated to take account of the fact that raw milk is now being used in ways that were not contemplated in 2001. For example, the ongoing use of the regulations by what are now established independent processors which are no longer in a set-up phase. The emerging trend is for international companies to use these regulations to source liquid milk to export to their home countries.
- 8.4 As members of the Commerce Select Committee will be aware, the regulatory framework for the dairy industry is currently under review by officials across departments. We note that the Select Committee intends to work in with the interdepartmental review and not duplicate its work. Federated Farmers will not go into further discussion on the regulatory framework but we have attached a copy of our recent submission to the Review of the Raw Milk Regulations, for the information of the Select Committee.

9. CONCLUSION

- 9.1 Although Federated Farmers does not believe this inquiry to be necessary at this time, we welcome the opportunity to engage with the Select Committee on a matter of great importance for farmers.
- 9.2 In answer to the Select Committee's overarching question, Federated Farmers does not believe New Zealanders are overpaying for milk. We do not believe that either the farm-gate or factory-gate prices are too high, especially considering the levels and movements of international dairy commodity prices. That said, we are keen to ensure that the regulatory framework for setting these prices works effectively and fairly. We are engaging with officials on these matters.

10. ABOUT FEDERATED FARMERS

- 10.1 Federated Farmers is a member based organisation that represents farmers and other rural businesses. Federated Farmers has a long and proud history of representing the needs and interests of New Zealand's farmers.
- 10.2 The Federation aims to add value to its members' 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.

APPENDIX: INTERNATIONAL COMPARISONS FOR MILK PRICING

Metropolitan France – June 2011

(<http://www.bdm.insee.fr/bdm2/affichageSeries.action?000442479=on&codeGroupe=162>):

- One litre of milk is €1.26 per litre
- On the current (5 August 2011) cross rate that's NZ\$2.21 but because their TVA (GST) is 5.5%; NZ\$0.21 more needs to be added. That makes it **NZ\$2.42** for one litre of milk
- France *also* receives €9.9 billion under the CAP (2009)
- <http://www.dairyco.net/datum/milk-prices-and-contracts/farmgate-prices/eu-farmgate-milk-prices.aspx> gives farm gate price for May EU-27 (across 27 countries) weighted average price stood at €33.35/100kg (30.10ppl),

Ireland – May 2011

(<http://www.cso.ie/releasespublications/documents/prices/current/apa.pdf>):

- One litre of milk is €1.10 per litre
- On the current cross rate (5 August 2011) that's NZ\$1.93 but because Irish milk is VAT exempt, NZ\$0.29 more needs to be added. That makes it **NZ\$2.22** for one litre of milk
- Irish farmers *also* received €404,994,800.00 in subsidy (2009)

United Kingdom – June 2011

(http://www.statistics.gov.uk/downloads/theme_economy/focus-on-cpi-jun-2011.pdf)

- One pint of milk (0.56l) is £0.46 (£0.82 per litre equivalent)
- On the current cross rate (5 August 2011) that's NZ\$1.68 but because UK milk is VAT exempt, NZ\$0.25 more needs to be added. That makes it **NZ\$1.93** for one litre of milk equivalent
- UK dairy farmers *also* receive approximately £529,849,200 in total support payments in 2009/10 (House of Commons "HC Deb 17 February 2011 cc925-6")
- <http://www.dairyco.net/datum/milk-prices-and-contracts/farmgate-prices/eu-farmgate-milk-prices.aspx> average UK farmgate price in May stood at €29.13/100kg (26.29ppl).

United States – June 2011 (http://future.aae.wisc.edu/data/monthly_values/by_area/307)

- One US half-gallon (1.89l) of milk is US\$1.61 is the official statistical element BUT a US quart (0.946 ml 'Lucerne' brand) retails on safeway.com at a litre equivalent price of US\$1.59
- On the current cross rate, (5 August 2011) a US quart would be NZ\$2.05 but as six states charge sales tax of less than 5%, NZ\$0.20 more needs to be added. That makes it **NZ\$2.25** for one quart of milk on a litre equivalency
- On the current cross rate (5 August 2011) a half-gallon made up to create a 2l equivalent would be US\$1.70 (NZ\$2.20) but as six states charge sales tax of less than 5%, NZ\$0.22 more needs to be added. That makes it **NZ\$2.42** for one half-gallon of milk on a 2l litre equivalency
- US dairy farmers *also* receive approximately US\$1.1 billion through various dairy programmes

Canada – June 2011 (<http://www40.statcan.gc.ca/l01/cst01/econ153a-eng.htm>)

- One litre of milk is CA\$2.27 per litre
- On the current cross rate (5 August 2011) that's NZ\$2.93 but as Canadian milk is sales tax exempt, NZ\$0.44 more needs to be added. That makes it **NZ\$3.37** for one litre of milk
- Canadian dairy farmers *also* received CA\$3.36 billion in subsidies (2009)

Australia – February 2011

(http://www.aph.gov.au/senate/committee/economics_ctte/dairy_industry_supermarket_2011/second_interim_report/c02.htm)

- One litre of Coles homebrand milk is currently AU\$1.25 whereas the 'Dairy Farmer' brand for one litre sells for AU\$1.88
- On the current cross rate (5 August 2011), that's NZ\$1.60 for Coles Home Brand but as Australian milk is GST exempt, NZ\$0.24 more needs to be added. That makes it **NZ\$1.84** for one litre of milk ('Dairy Farmer' branded milk, if treated equally, is NZ\$2.77)
- <http://www.dairyaustralia.com.au/Statistics-and-markets/Prices/Farmgate-Prices.aspx>
[09/10](#) FG price = \$4.98/kgms (37.3c/l)
- On 26 January 2011 Coles announced its 'Down Down' campaign that saw the price of Coles Brand fresh milk cut by as much as 33 percent, to AU\$2.00 from AU\$2.66 (with FX and GST factored in, the pre-cut price for 2l of Coles homebrand milk was actually equivalent to NZ\$3.98).
- (http://www.aph.gov.au/senate/committee/economics_ctte/dairy_industry_supermarket_2011/second_interim_report/c02.htm)