Founding rationale for national dairy exporter

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The foundation beliefs for a near-monopoly (national) dairy exporter stem from 1923 when international dairy prices plunged

First dairy producer board

- In the years following World War I, there was a large over-supply of butter in the UK. Wholesale prices for butter crashed by about 50% (a plunge similar to the dairy price drop over the last two years – 2014 to 2016). In the early 1920s, dairy products also represented a significant proportion of total exports (22% then compared to 29% today)

- Frozen meat prices had a similar downward slide and the Government passed the Meat-export Control Act, 1921-22 with a view to controlling exports and influencing see-sawing prices.

- Dairy farmers sought similar legislation . The Dairy-produce Export Control Act was passed in 1923 (after a vote of dairy farmers approved it) and the Dairy-produce Board of Control was established.

First dairy producer board *(cont'd)*

As Clive Lind explains:

> "The thinking behind the [1923] legislation was reasonably straightforward. It was an attempt to give producers some combined strength when the market became difficult. The system was not designed to try to control the market – which would undoubtedly fail given milk's widespread availability – but to enable the Board to manage the flow of products to minimise the effects of the worst declines".

> "The Board's powerful negotiating position resulted in huge shipping cost reductions, but market prices were still not where farmers thought they should be. This aggravated the tension between proprietary companies – with their close links to importers – and the cooperatives whose representatives, deep down, knew they were not able to market as effectively as they would like".

First dairy producer board *(cont'd)*

This rationale later evolved into the idea that a single dairy exporter from New Zealand could get higher prices for its products than competing exporters.

This became an article of faith that determined the shape of the industry for most of last century and led to the formation of Fonterra.

Economic analysis

In discussing the price slump and other factors that led to the first Dairy Board in 1923, Veronica Jacobsen, Grant Scobie and Alex Duncan point out in a 1995 World Bank paper that:

> “Little if any analysis was undertaken of the underlying causes, nor was any consideration given to a range of policy responses, which might have led arguably to an assessment of the alternatives. Producers, dissatisfied with the returns they were receiving, felt typically that either international prices were inequitable, or that their share of the world price was unjustly low.

Economic analysis *(cont'd)*

Veronica Jacobsen, Grant Scobie and Alex Duncan continue:

"If prices on world markets were too low, then it was argued that collective action by producers would provide countervailing market power which would allow them to extract greater returns.

If on the other hand, the depressed returns to growers were a consequence of inefficiency or exploitation by those marketing or processing the products, then grower control of these functions was seen as a way to avoid the excessive costs imposed by 'middle-men'"

"The effect of these [single seller] powers is to create a regulatory environment which restricts choice, limits competition, creates barriers to entry, encourages wasteful rent seeking and generates signals that distort the way scarce resources are allocated (ACIL, 1992; Finlayson, 1993).

Economic analysis *(cont'd)*

Veronica Jacobsen, Grant Scobie and Alex Duncan continue:

"Whether it is possible to duplicate the conditions required for a monopolist to exercise market power in an export market depends critically on:

– how costly it is for new entrants, such as foreign competitors, to enter the market, given the state of technology. Other countries are not bound by restrictions imposed by New Zealand, when they trade the same type of meat or its substitutes. By controlling activities of New Zealand exporters in foreign markets, interventions may in fact deliver markets to third countries and inhibit the development of marketing expertise among New Zealand exporters; and

Economic analysis *(cont'd)*

- how readily consumers can choose cheaper substitutes. As noted above, in the telecommunications sector, even though it is costly for new entrants to set up a competing local network, there are potential substitutes such as mobile phone networks. These substitutes limit the ability of the monopoly supplier of the telephone network to exploit its position."

"The situation in export markets for New Zealand's agricultural products means that it is unlikely that both of the above conditions can be met for anything other than a short period of time. This severely limits the ability of single sellers to influence underlying prices, as Australian wool growers found to their cost with the collapse of their reserve price scheme".

Source: http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/1995/07/01/000009265_3961219102755/Rendered/PDF/multi_page.pdf

Economic analysis *(cont'd)*

- Over many years, dairy leaders have perpetuated a myth that, with a near-monopoly exporter, New Zealand as market power – an ability to achieve higher prices for its basic dairy commodities:
- These claims of market power have been widely and authoritatively rebutted by Prof Evans and many others.
- Finlayson, Lattimore, Ward determined in 1998 that if NZ reduced exports by 10%, world price would fall by less than 0.5%
- Except for a few narrow quota markets, Fonterra has *no* significant ability to raise world commodity prices

Economic analysis *(cont'd)*

- Fonterra argues that its international supply chain management and handling of third party milk products helps smooth some potential short-term price fluctuations
- However it is clear that Fonterra cannot fundamentally change commodity prices
- There is a substantial body of further economic analysis refuting the rationale and claimed benefits of an artificially created highly dominant New Zealand dairy exporter.
- Anyone trading commodity-related dairy products in competitive markets is a price-taker, not a price-maker. About this our Commerce Commission and other authorities are unequivocal.