DIRA Q & A's

1. Why are you doing the Review?

The review is intended to ensure that the dairy industry operates in a way that protects the long term interests of farmers, New Zealand consumers and the wider economy.

The review is considering the effectiveness and impact of the Dairy Industry Restructuring Act 2001, (DIRA) across a range of parameters, including incentives and/ or disincentives it creates for the dairy industry to transition to:

- higher value dairy production and dairy processing that global consumers seek out for a premium;
- more sustainable environmental practices on and off farm.

2. Who is doing the review?

The review is being led by the Ministry for Primary Industries in close collaboration with other government agencies, including (but not limited to) the Ministry of Business, Innovation and Employment, the Ministry for the Environment, the Treasury and the Ministry of Foreign Affairs and Trade. Officials will be supported by a team of external experts in competition law and policy, economic regulation, corporate strategy and finance, as required.

3. Where can I can check for updates on the review?

DIRA review updates, including a link to the terms of reference, are posted on www.mpi.govt.nz/DIRA-review. To receive news and updates about the DIRA review, email dira@mpi.govt.nz.

4. Didn't the Government just do a review of the DIRA?

In 2015, the Government requested a report from the Commerce Commission on the state of competition in New Zealand dairy markets. This was required by provisions in the DIRA, to determine whether the level of competition to Fonterra was sufficient to allow key aspects of the regulatory regime (such as open entry and exit) to expire in the South Island. At that time the DIRA included sunset provisions, which were triggered when independent dairy processors collected more than 20 percent of milk solids on or from dairy farms in either the North Island or South Island in any season. Once the 20 percent market share threshold was met, a process commenced that could lead to expiry of the key DIRA provisions in the relevant island. The process was triggered in 2015 when independent processors collected 22 percent of milk solids in the South Island.
The Commerce Commission's report was followed by a review of the regulatory settings, but the results of that review were not implemented prior to the 2017 election.

The incoming Government passed legislation to prevent the expiry of the DIRA regulatory regime In the South Island (which would otherwise have occurred automatically in May 2018), and announced a broader and more strategically focussed review of the DIRA and its impact on the dairy industry overall.

5. Does the upcoming review include sheep, goat etc. dairy activities, or is it confined to bovine milk?

The Review will only focus on cow dairy, as the DIRA only covers cow dairy.

6. What is the budgeted cost/actual spend? How many staff are working on it? When is it due back?

The DIRA review will be funded from within MPI baseline funding.

The review is being undertaken by MPI staff, with support and input from other government agencies. Specialised legal and economic expertise is also being sought where required.

The number of people involved in the review will be flexed to meet resourcing requirements at each stage. Since September 2018, there has been a team of 6.0 full-time equivalent staff involved in work for the review of the DIRA and its impact on the dairy industry.

The review commenced on 9 May 2018 with the release of the terms of reference. We anticipate any resulting legislative amendments are to be completed by the end of 2019.

7. Is the Minister's Primary Sector Council going to be doing/involved in the review? Who is going to be leading it?

The Primary Sector Council has been established to provide independent strategic advice to the Government on issues confronting the primary industries. They will work to develop a sector-wide vision and facilitate the development of individual strategic plans for each of the sectors. These plans will encompass elements such as sustainability, industry development, future value creation, technological innovations, global markets, social licence and rural resilience. MPI has discussed the review with the Council, and they will continue to have input during the course of the Review. However, the Review process and subsequent advice to the Government will be led by MPI.

8. What does the review mean for Fonterra and farmers?

It is not possible to pre-empt the outcomes of the review. However, it will look at the key regulatory tools and issues in the DIRA. These are matters that regulate Fonterra and have implications for dairy markets, farmers, processors and consumers. These include:

- Open entry and exit – Fonterra must accept any application to become a shareholding farmer in Fonterra, and accept supply of milk from that shareholder. Shareholding farmers can also readily exit from Fonterra and supply another dairy processor, should they wish to do so. Open entry and exit are the most significant of the DIRA provisions, as they help to ensure that milk (and land) can be directed to its highest value use, new processors entering the industry can compete for milk supply, and Fonterra is incentivised to price milk efficiently.

- Milk price monitoring regime – the milk price monitoring regime is intended to promote transparency around Fonterra's farmgate milk price setting and provides a reference point against which farmers can assess Fonterra's and other dairy processors' milk price offers. The DIRA requires the Commerce Commission to review Fonterra's farmgate milk price calculation at the end of each dairy season. The Commission is also required to review Fonterra's farmgate Milk Price Manual. The Manual sets out Fonterra's methodology for calculating its base milk price each season.

- Raw Milk Regulations – these regulations are made under the DIRA and provide an entrance pathway for new processors into the farmgate milk market, and processors servicing the New Zealand domestic consumer market for dairy products. The regulations require Fonterra to sell prescribed quantities of raw milk to processors at a regulated or negotiated price. Eligibility ceases when a processor has its own supply of 30 million litres or more for three consecutive seasons.

9. New Zealand exports are very exposed to shifts in commodity prices. Why doesn't New Zealand produce more value added products for export?

New Zealand does produce a wide range of dairy exports, from commodities through to high value nutritional, organic and pharmaceutical products. Commodities have a place in that product mix because New Zealand's pasture based production results in large seasonal volumes of milk. Given the volume, and the perishability of fresh milk, some of that production has to be turned into milk powder, which can be readily stored, has longevity and meets significant international demand.

10. Don't the open entry requirements cause farmers to increase milk supply, thus forcing Fonterra to keep investing in commodity processing rather than value-added products?

Fonterra can influence the amount of milk produced through the price it pays farmers and the DIRA also allows Fonterra to decline uneconomic milk or recover transport costs. Independent analysts have concluded that the growth in milk supply has been primarily driven by international demand for commodity products and high international prices, rather than the DIRA.

11. Why do consumers in New Zealand have to pay so much for milk?

The DIRA does not set prices for consumer milk. MPI commissioned independent analysis, which has indicated that, in general, consumer dairy prices (including fresh milk) have moved in line with prices for other grocery products. There have been fluctuations from time to time (e.g. butter) but the general trend suggests that there is no significant disparity in the movement of dairy goods compared with other grocery items.

Retail milk prices are more stable than international dairy prices and do not necessarily fall or rise in line with movements in international commodity prices. While retail milk prices have not fallen by as much as global dairy prices, they also tend not to increase as much when the global price rises. This stability is due to the fact that raw milk makes up only a portion of the cost of processed retail milk.

The price paid by consumers includes a wide range of costs incurred by processors and supermarkets, such as the costs of processing, packaging, labour, transport and retail storage, handling and overheads.

12. Why does Fonterra have to supply milk to other processors?

Regulations made under the DIRA allow independent processors to buy up to 50 million litres of raw milk per season from Fonterra for a regulated price. Goodman Fielder (which manufactures brands such as Meadow Fresh and Puhoi Valley) has a separate entitlement to purchase up to 250 million litres per year. The 50 million litre allocation provides an entrance pathway for independent processors into the farm gate milk market, and supports competition in the domestic dairy product markets. The allocation for Goodman Fielder is to ensure that there is at least one large scale competitor to Fonterra, in the domestic milk consumer market, producing basic dairy products such as fresh milk, butter and cheese. The total amount of raw milk that Fonterra is required to supply in a season is capped and is reviewed regularly (currently the total quantity is 600 million litres per season) and must not exceed 5 percent of the milk Fonterra collects.

A processor ceases to be eligible to buy this regulated milk once it has obtained its own supply of 30 million litres of raw milk from its own farmers for three consecutive seasons.

Due to this ‘own supply’ rule, the majority of processors now buying regulated milk from Fonterra (other than Goodman Fielder) are small companies supplying the domestic market with products such as specialty cheeses and yoghurts. The majority of large scale exporting processors who have become established in New Zealand are no longer entitled to purchase regulated milk from Fonterra.

13. Why does New Zealand help foreign companies to establish in New Zealand: doesn’t this hurt New Zealand’s dairy export trade?

MPI's preliminary analysis, supported by independent consultants, is that other large exporting processors are not taking market share from Fonterra in export markets. There are differences in product profiles. In addition, many processors have relationships with overseas distribution channels that provide market access that would not otherwise be available. This suggests that the total export market and return on exports is increased by the establishment of other processors in New Zealand.

14. Why are financial, environmental, and animal health and welfare identified as being outside the scope of review?

The review will consider whether the DIRA is having any unintended consequences on the environmental performance of the dairy industry. However, consideration of individual dairy farms' financial, environmental and animal health and welfare performance are outside the review's scope as they are part of MPI's Farm Systems Change initiative.

Although the review will focus on the DIRA regulatory regime, it will take account of the fact that the DIRA operates within, and has important linkages to, the wider regulatory system. This wider regulatory system includes, but is not limited to, the Resource Management Act, the Animal Welfare Act, the Health and Safety at Work Act, the Immigration Act, the Overseas Investment Act, the Financial Markets Conduct Act and the Commerce Act.

The environmental impacts of dairy farming are being actively addressed in a number of ways, across the Government's programmes to address climate change, biodiversity, water quality, and sustainable land use.

15. Does the DIRA contribute to environmental degradation? And what can be done to stop this from happening?

The growth of the dairy industry has had negative impacts on the environment. Some stakeholders consider that the DIRA's open entry requirements have contributed to these negative environmental outcomes. The concern is that open entry provides farmers with a guaranteed buyer (Fonterra) for all and as much milk as they choose to produce, resulting in overproduction of milk and expansion of dairying beyond sustainable environmental limits.

However, our preliminary analysis indicates that the main driver for the growth of the dairy industry and consequent impact on the environment, appears to be the incentives created by growing international demand for dairy products and associated high prices for commodities.

The Resource Management Act 1991 (the RMA) empowers local communities to make decisions on how their environment is managed through regional and district plans. Accordingly, regional and local authorities play a critical role in determining what land use and economic activity, including dairying, can be established and under what conditions, to ensure that they are environmentally sustainable.

The Ministry for the Environment is currently progressing policy work on its Essential Freshwater work programme. This programme has three objectives: stopping further degradation and loss of our freshwater resources; reversing past damage; and addressing water allocation issues.

Dairy processors have also introduced programmes to support and recognise their farmer-suppliers who are taking measures to minimise the impact of their milk production on the environment. For example:

- **Fonterra** runs a Fonterra's Sustainable Dairying Programme, Tiaki, which is a network of Sustainable Dairy Advisers, who provide advice to farmer-suppliers.
- **Synlait** runs its Lead with Pride programme, which recognises and financially rewards farmer-suppliers who achieve best practice standards.
- **Miraka** has its Te Ara Miraka Farming Excellence programme that aims to improve efficiency and produce high quality milk, improving profitability for farmer-suppliers and Miraka, with a lower environmental footprint.

16. Wouldn't the new conversions measures have been helpful in managing the environmental impacts of dairying?

The 2015/16 review included a proposal to allow Fonterra discretion as to whether to accept or decline an application from a new dairy conversion to become a Fonterra shareholder/supplier. This measure was proposed by the Commerce Commission as a means of mitigating any risk of asset stranding that Fonterra might incur as a result of open entry and exit, that is, it was intended to allow Fonterra some discretion in managing its milk supply. It was not proposed as a means of managing environmental outcomes, and in fact, it would not have been effective in this regard. Fonterra could still have accepted supply from new conversions if it wished to do so. Further, it remained open to any other processor to accept supply from a new conversion.

The DIRA's purpose is to support efficiency and contestability in the dairy industry. The DIRA operates within, and has important linkages to, the wider regulatory system. The Resource Management Act is the proper statute for regulating environmental matters and that Act includes detailed processes and extensive powers to manage environmental impacts of dairying, along with other activities.

17. Is the review going to consider the Productivity Commission's recent query about the DIRA with regard to climate change?

Yes, MPI will take the Productivity Commission's recent query about the DIRA with regard to climate change into account during the review.

18. Is Mycoplasma bovis likely to change what the dairy industry looks like?

It is too early to determine what impacts Mycoplasma bovis will have on the dairy industry. However, we urge farmers to practice good on-farm biosecurity and look out for signs and report the disease. Importantly, we want to ensure that farmers are complying with NAIT requirements when sending and receiving movements of cattle. Key Mycoplasma bovis information for all farmers, contractors and transporters can be found on our website - http://www.mpi.govt.nz/protection-and-response/responding/alerts/mycoplasma-bovis/advice-for-farmers-rural-contractors-and-transporters/

MPI understands this is a difficult time for all farmers, particularly those affected by Mycoplasma bovis. With this in mind, MPI is committed to ensuring affected farmers are given all the tools they need to help them get back on their feet as soon as possible through mechanisms such as compensation and welfare recover support.