

Commerce Commission

Review of the state of competition in New Zealand's dairy markets

1 March 2016

Sue Begg, Deputy Chair



Briefing overview

- What the review covered
- Our approach
- Our key conclusions and recommendations
- Next steps



What the review covered

The Minister for Primary Industries requested a report on the state of competition in the New Zealand dairy industry

- The **purpose of the review** is to:
 - provide an assessment on whether the state of competition in the dairy industry is sufficient to justify deregulation
 - advise the Minister on whether the ‘market share thresholds’ in DIRA should be reset; and
 - the options (if any) for a pathway to deregulation

Our approach

We considered:

- What competition looks like with the DIRA Regulation
- What competition would look like without the DIRA Regulation
- The efficiency costs and benefits created by the DIRA Regulation
- We focussed on the farm gate and factory gate markets

Final conclusions

Our final conclusions are consistent with our draft views

- The DIRA regulation has reduced barriers to entry and constrained Fonterra's market power
- Some competition (varying by region) has developed in the farm gate market
- Little competition has developed in factory gate market

Final conclusions (cont)

Fonterra's market power without DIRA regulation

- Fonterra would have substantial market power in the farm gate and factory gate markets
- Our primary concern is that competition in the factory gate market is not yet sufficient to fully deregulate
- Fonterra would continue to have market power in the farm gate market but limited incentive and/or ability to exercise it

Final conclusions (cont)

On balance we do not recommend full deregulation

- Efficiency costs and benefits of removing regulation are of a similar order of magnitude
- But staged deregulation would reduce transition costs, provide options and reduce risk

Factory gate market

Risk from deregulating when competition in the factory gate market is very limited

- Deregulation now could allow Fonterra to increase the price of raw milk it sells to processors producing dairy products for the NZ market
- This could result in an increase in the retail price of milk, yoghurt, cheese and a reduction in variety/quality

Factory gate market (cont)

- Immediate deregulation could result in an efficiency loss from increases in prices for domestic dairy products
- But regulation imposes costs on Fonterra, principally in terms of need to provide excess capacity
- Staged deregulation would reduce efficiency loss from potential price rises for raw milk, while reducing Fonterra's capacity costs

Pathway to deregulation

We propose Ministers look at deregulation options that may facilitate development of the factory gate market

- Reduce independent processor entitlements (including Goodman Fielder's)
- Tighten conditions for supply of regulated milk
- Retain open entry and exit provisions during transition (to assist in further development of factory gate market)



Pathway to deregulation

We also propose that Ministers

- Consider removing open entry requirement provisions for new conversions since these don't assist competition and impose costs on Fonterra
- Consider further deregulation depending on how and when competition develops in the factory gate market



Resetting the thresholds

We recommend the Ministers

- Reset the ‘market share’ threshold to 30%
- Reset the ‘time limit’ thresholds to trigger a future report on the state of competition 2021/22 (five years time)
- We expect review to be triggered by time threshold
- Market share threshold provides a back stop if competition develops more quickly than expected



Next steps

Within 90 days of receiving our report, DIRA requires the Minister to give notice of whether the Minister:

“...intends to promote the enactment of legislation that resets either or both of the market share thresholds specified in s 147 or to promote the adoption of measures that provide a transition pathway to deregulation, or to promote both.” – s 148(3) DIRA

Questions?



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