

Chair
Cabinet Economic Development Committee

Review of the Dairy Industry Restructuring Act 2001 and its impact on the dairy industry: release of discussion document

Proposal

1. The Minister of Agriculture is seeking Cabinet's agreement to release the discussion document (attached as Appendix One) as the basis for public consultation on the review of the Dairy Industry Restructuring Act 2001 (the DIRA) and its impact on the dairy industry.

Executive Summary

2. In 2001, the DIRA enabled the dairy industry to merge processing and marketing assets into a single farmer-owned dairy co-operative company, Fonterra. The aim of this was to provide the merged entity with sufficient scale to compete in international dairy markets and create impetus for strategic change, while also managing Fonterra's dominance domestically.
3. The main purpose of the DIRA regulatory regime is to prevent Fonterra from using its dominance to create barriers to farmers' milk, and farmland, flowing to their highest value use. DIRA achieves this by ensuring that dairy farmers have access to information about Fonterra's performance and can act on this information by freely switching their supply to and from Fonterra.
4. The dairy industry has had mixed performance outcomes since its 2001 restructure. The sector's economic contribution to New Zealand has more than doubled. However, this growth has been driven primarily by increased commodity production and rising cow numbers, which has had negative impacts on the environment. Some industry stakeholders are concerned that the DIRA regulatory regime may have unintentionally accounted for some of these performance outcomes.
5. Following the release of the terms of reference for the DIRA review (attached at Appendix Two) on 9 May 2018, the Ministry for Primary Industries (MPI) engaged with key industry stakeholders to help clarify concerns, establish facts and build evidence to support MPI's preliminary analysis of issues and options.
6. The attached discussion document is seeking wider industry and public input to ensure that any legislative amendments deliver the right outcomes, are workable, and any unintended consequences are mitigated.

7. The purpose of the discussion document is to test MPI's preliminary analysis of the industry concerns, establish the underlying policy issues, and identify options for potential legislative amendments to achieve the right balance between reducing any unintended consequences and ensuring effective ongoing management of Fonterra's dominance.

Background

8. In May 2018, Cabinet agreed to the terms of reference for the DIRA review [CAB-18-MIN-0191]. The Minister of Agriculture subsequently announced the Government's intention to conduct a review, with the aim of consulting stakeholders in late 2018 and early 2019, and making policy recommendations to Cabinet in the first half of 2019.
9. The terms of reference provide for a comprehensive review of the DIRA. This differs significantly from the review that was carried out in 2016, following the Commerce Commission's report on the state of competition in the dairy industry. The 2016 review was narrowly defined by statute and did not permit wider issues to be addressed.
10. The Government's vision is to build a productive, sustainable and inclusive economy. The dairy sector is critical to achieving that vision, given its substantial economic, environmental, and social impact. New Zealand needs a high performing, sustainable dairy industry, and a regulatory environment that promotes that performance. This review provides an opportunity to consider:
 - whether the DIRA regulatory regime is operating in the long term interests of New Zealand dairy farmers, consumers, and the wider economy (including its economic, social and environmental components);
 - whether, and if so the extent to which, the DIRA regulatory regime gives rise to any unintended consequences; and
 - whether the purpose and form of the DIRA regulatory regime remains relevant and fit-for-purpose.
11. The DIRA is an important piece of legislation, but it operates in a wider context of regulatory, social and economic factors that have undergone substantial changes since the DIRA was passed in 2001. The wider context includes the changing dynamics of international trade, consumer and social expectations, business investment strategies, new technologies, and a more sophisticated understanding of environmental limits.
12. In considering the impact of the DIRA on the dairy industry, the review takes account of factors, other than the DIRA, that impact on the dairy industry's economic, environmental and social performance.

Comment

MPI engagement process to date

13. MPI has undertaken an extensive preliminary engagement programme, seeking a wide range of perspectives, to help inform the development of the discussion document. MPI officials have travelled extensively to meet with a range of stakeholders including dairy processors, farmers, groups' representative of Māori interests, and financial institutions. A list of the 32 groups and individuals MPI has met with is set out in the table below.

MPI stakeholder meetings	
Processors	
Aunt Jean's Dairy	Fonterra
Fresha Valley Processors Ltd	Goodman Fielder
Green Valley Dairies	Mataura Valley Milk
Miraka	Oceania Dairy Ltd
Open Country Dairy Ltd	Synlait Milk Ltd
Tatua	Westland Milk Products
Representative Groups	
Dairy Companies Association of New Zealand	DairyNZ
Federated Farmers	Fonterra Shareholders Council
Farmers	
Fonterra farmer shareholders	Golden Bay farmers group
Miraka farmers	
Representatives of Māori interests	
Federation of Māori Authorities	Parininihi ki Waitotara
Non-Government Organisations	
Environmental Defence Society	Fish and Game New Zealand
Forest and Bird New Zealand	Greenpeace
Industry Commentators	
First NZ Capital	Hamish Gow
Peter Fraser	

14. MPI has also commissioned independent consultants, Frontier Economics¹, to undertake a detailed industry analysis that supports the preliminary analysis that formed the basis for the discussion document. Frontier Economics' analysis was focused on the performance of the industry to date, and the underlying drivers of that performance.
15. In addition to the MPI engagement process, The Minister of Agriculture met with a number of industry analysts and commentators to test assumptions and ensure that the discussion document provides a solid basis for a robust conversation.

¹ Frontier Economics were selected through a robust procurement process. Selection criteria focused on experience in economic and industry performance analysis, understanding of regulatory economic frameworks, and ability to effectively manage any conflict of interests.

Content of the discussion document

16. The purpose of the discussion document is to test MPI's preliminary analysis and understanding of industry and the public's concerns, draw out underlying policy issues and identify a range of options for potential legislative amendments.
17. The discussion document does not identify preferred options. Instead, MPI is seeking feedback on all options outlined in the discussion document, and any additional ones stakeholders may put forward, to help inform recommendations for potential legislative amendments. Specifically, the discussion document is seeking feedback on what may or may not work in practice and whether any legislative amendments may be warranted to meet the Government's objectives for the review.
18. MPI's preliminary analysis suggests that the DIRA is an effective tool in managing Fonterra's dominance and is unlikely to be encouraging inefficient industry growth or preventing Fonterra from transitioning to higher value-add dairy processing. It may be preventing Fonterra from effectively managing its farmers' environmental performance, thus exposing Fonterra, its farmers, and the wider dairy industry to reputational risk. The options in the discussion document seek to achieve the right balance between reducing unintended consequences and preserving the effectiveness of the DIRA in managing Fonterra's dominance.
19. The discussion document highlights that the issues are complex, and the performance of the dairy industry, and its impacts on the environment, economy, and New Zealand consumers results from the interplay of a number of factors, of which the DIRA is one.

Fonterra's business strategy, co-operative structure and performance

20. A key issue that the discussion document highlights but does not address is the impact of Fonterra's business strategy, co-operative structure and performance on the dairy industry.
21. This is outside the scope of the DIRA regulatory regime, whose role is not to prescribe how Fonterra should operate or what organisational form it must take. Instead, the DIRA ensures that such decisions are made by its private owners, the dairy farmers, having had access to transparent information about Fonterra's performance and an unimpeded ability to "vote with their feet" should they be dissatisfied with the performance of their co-operative.

22. Nevertheless, Fonterra is a significant force in the dairy industry, which, in turn, is a significant contributor to the New Zealand economy and the Government's objectives for sustainable economic development. Fonterra is New Zealand's largest company and the only New Zealand-based multinational firm with global scale and reach. Its revenue and profit streams are captured in New Zealand by its New Zealand-based shareholders. The presence of Fonterra's head office, innovation and manufacturing activities in New Zealand also produce spill over benefits for the wider New Zealand economy and the regions (e.g. training of an investment in skilled personnel). There is therefore a national interest associated with Fonterra and its performance.
23. While Fonterra's accountability for its strategy, structure and performance lies with its private owners, the Government does have a critical role to play in setting the regulatory and trade environment within which Fonterra, its farmer-shareholders, and the wider dairy industry operates. The key levers for the Government include:
- ensuring regulatory certainty to enable Fonterra, its farmer-shareholders and all other industry players to plan and operate in line with their chosen long term strategic direction and environmental limits;
 - maintaining an effective regulatory environment that applies sufficient performance pressure on Fonterra and ensures that milk production can flow to its highest value use, despite Fonterra's dominance;
 - protecting and enhancing international market access for New Zealand dairy exports;
 - providing targeted research and development incentives to promote innovation and development of higher value added dairy products and market development opportunities; and
 - helping build dairy farmers' capability to focus on longer term strategic wealth creation incentives (as owners and shareholders in Fonterra) rather than shorter term financial revenue incentives (as suppliers of milk to Fonterra), through a farmer education programme, e.g. similar to the way the Government is currently helping grow dairy farmers' on-farm management capability through the Farm Systems Change programme.

Next steps

24. The Minister of Agriculture proposes to carry out the DIRA review consultation process over November 2018 to February 2019, and to report back to Cabinet with policy recommendations in April 2019. The consultation process will be through a formal call for written submissions, supported by extensive engagement throughout the country.
25. The consultation process is slightly longer than usual. However, given the impact the DIRA has on farmers, rural communities and the wellbeing of all New Zealanders, I have asked MPI officials to ensure that their engagement includes opportunities for those in rural areas to participate close to their homes and places of work. Due to the logistical challenges this posed, a longer consultation period is required to accommodate this process.

26. As part of the consultation process, officials will hold public meetings throughout New Zealand to provide the opportunity for all those with an interest to engage in the discussion. These meetings will supplement targeted meetings with (but not limited to) processors, industry representative groups, farmer reference groups, local and regional councils, consumer and environmental groups.
27. In line with the Government's commitment to improving the Crown-Māori relationship, officials will work to ensure that Treaty settlement commitments, and MPI's existing arrangements with iwi, are reflected in the engagement approach.
28. To ensure that engagement with Māori is broad and inclusive, officials will also undertake meetings with a wide range of Māori interest groups. Alongside representative groups from each of the major processors, officials will engage with a range of groups including (but not limited to) the Federation of Māori Authorities, New Zealand Māori Council, Ahu Whenua farming interest groups, Te Tumu Paeroa, and the Iwi Leaders Forum.

Consultation

29. As noted above, MPI has carried out preliminary engagement with key stakeholders to inform the discussion paper.
30. The following agencies have been consulted on this Cabinet paper and the discussion paper: the Treasury, the Ministry of Business, Innovation and Employment, the Ministry for the Environment, the Ministry of Foreign Affairs and Trade, the Office of Treaty Settlements (Crown-Māori Relations) and Te Puni Kōkiri. The Department of the Prime Minister and Cabinet and the Commerce Commission have also been informed of the content of this paper.

Financial Implications

31. No financial implications arise from the recommendations in this paper.
32. There are no financial implications arising from the proposal to release the attached discussion document for public consultation. MPI expects to hold approximately 13 public meetings around New Zealand, additional to meetings with industry and other key stakeholders, and the costs associated with these will be met from MPI's existing baselines.

Human Rights, Gender Implications and Disability Perspective

33. The Minister of Agriculture considers the proposal to release the discussion document for public consultation is consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993. There are no gender or disability implications arising from this paper.

Legislative Implications

34. There are no immediate legislative proposals arising from this paper. However, the proposed consultation is intended to lead to policy recommendations to Cabinet concerning the future shape of, and potential amendments to, the DIRA. This may in due course require an Amendment Bill.

Regulatory Impact Analysis

35. The Regulatory Quality Team at the Treasury has determined that a separate Regulatory Impact Assessment is not required to accompany this Cabinet paper on the grounds that the relevant regulatory issues would be outlined in the attached discussion document. The purpose of the discussion document is to test MPI's current understanding of, and seek input on, policy issues and a range of feasible options following the DIRA review.
36. The discussion document has been reviewed by a joint panel drawn from the Regulatory Impact Analysis (RIA) Teams in the Treasury and MPI.
37. The panel's view is that the problem definition and high-level objectives are clearly outlined. Feedback is being sought through an open consultation process on the proposed options as well as alternative options. However, there is limited analysis of the impact of the proposed options. While the consultation process is likely to elicit further information, the level of impact analysis in the document may constrain the ability of some stakeholders (especially dairy farmers and domestic consumers) to provide informed submissions.
38. A regulatory impact assessment will be required when final decisions are being sought from Cabinet. It will be necessary to analyse the costs, benefits, and impacts of the options in more depth to develop a convincing case for any regulatory changes.
39. MPI notes the concerns raised by the joint RIA panel and considers these will be addressed during the public consultation process and subsequent analysis of preferred options.

Publicity

40. The Minister of Agriculture intends to issue a media statement accompanying the release of the discussion document. The discussion document will be made publicly available on the MPI website.
41. MPI will work with the Minister's office to manage any media interest arising during the course of the consultation period.

Proactive release

42. The Minister of Agriculture proposes to release this Cabinet paper, and publish it along with the discussion document on the MPI website. The Minister of Agriculture also proposes to release the supporting material provided by

interested parties, with redactions made in accordance with the relevant provisions of the Official Information Act 1982.

Recommendations

43. The Minister of Agriculture recommends that the Committee:
1. **Note** that Cabinet agreed to a comprehensive review of the Dairy Industry Restructuring Act 2001 and its impact on the dairy industry [CAB-18-MIN-0191].
 2. **Note** that MPI has prepared the attached discussion document (Appendix One) which has been informed by independent analysis of the New Zealand dairy industry, preliminary engagement with a wide range of stakeholders and input from other government agencies.
 3. **Note** that the purpose of the discussion document is to test MPI's preliminary analysis of industry concerns, establish underlying policy issues, and identify options for potential legislative amendments.
 4. **Agree** to release the attached discussion document as a basis for public consultation.
 5. **Note** that the consultation process will run over November 2018 to February 2019 period, to allow engagement to take place across the country.
 6. **Agree** to proactively release this Cabinet paper via the MPI website at the same time as the discussion document.
 7. **Invite** the Minister of Agriculture to report back to Cabinet on the outcomes of the consultation process and policy recommendations by 30 April 2019.

Authorised for Lodgement

Hon Damien O'Connor
Minister of Agriculture
/ / 2018