New Zealand Dairy Menace Extends

by Jim Eichstadt

Clostridium botulinum-tainted New Zealand whey proteins made big headlines and triggered import bans across Asia and beyond in early August 2013. But a far more sinister Kiwi dairy menace to global markets has gone largely unnoticed for decades.

New Zealand's Fonterra Co-Operative Group Ltd – the world's largest and most aggressive dairy exporter – systematically dominates and manipulates markets worldwide. U.S. milk producers continue to pay a heavy price for Fonterra's market interference at home and abroad. Unlike the outbreak of contaminated dairy powders, the Fonterra threat is complex and doesn't provoke catchy headlines that trigger public outrage and lead to swift government action.

I have followed the New Zealand dairy export juggernaut with great interest and concern for more than three decades – in various capacities as a dairy co-op official, participant in global trade events, and industry consultant. Despite all the problems the Kiwis have caused in this nation's domestic markets, some of Fonterra's staunchest defenders are in the U.S.

If U.S. dairy "leaders" and politicians had honestly recognized Fonterra's real threat, they would have taken swift action decades ago. American farmers and consumers remain vulnerable. So complete and successful is Fonterra's ploy that its clueless U.S. victims – including the Free Trade-loving National Milk Producers Federation – shamelessly continue pandering to New Zealand political interests in Washington, D.C. and collaborate to advance Fonterra's free trade goals on the world stage.

Fonterra, with an estimated market share of up to 40% of all international dairy trade, inherited its predecessor's genetics as a manipulative monopoly exporter, along with its vast global marketing empire. Fonterra uses these unfair advantages to penetrate and dominate global markets. Unsophisticated U.S. dairy co-op leaders seem particularly vulnerable to New Zealand's charms – as joint venture partners and unwitting political allies – in ways that defy reason and self-interest. Fonterra has exploited these U.S. weaknesses at great cost to Americans who produce and consume milk and dairy products.

Export monopoly granted in 1961

Some history is in order. Fonterra is the current incarnation of the New Zealand Dairy Board (NZDB), a government-sanctioned export monopoly created by Parliament under the Dairy Board Act of 1961. The NZDB was a State Trading Enterprise (STE) that controlled all New Zealand dairy exports through an extensive global network of subsidiaries in the U.S., Europe, Asia, South America, and other key markets. That network remains intact today.

Since New Zealand consumes 10% or less of its own milk production, exports of the remaining 90% to 95% have long been critical. To its credit, NZDB was skillful in developing and marketing new products adapted to the differing tastes of consumers in many different countries. Fonterra continues that policy. U.S. dairy co-ops – which for decades sold commodity Cheddar cheese, butter, and nonfat dry milk to the government under the price support program – have lagged far behind in developing new products demanded by domestic and global consumers.

Playing by a different set of rules

Monopoly status allowed NZDB to play by a far different set of rules than its non-STE competitors. NZDB played hardball in all the exports markets it entered, a practice that Fonterra continues. Using its strength as a monopoly exporter, NZDB would typically sweet-talk its way into joint ventures in the target foreign market, and then muscle its domestic partners aside or into submission once Kiwi control was firmly established.

This kind of behavior gets noticed, and NZDB was not the only export monopoly behaving rudely in the marketplace. By the 1980s, agricultural STEs – including NZDB, the Canadian Wheat Board, the Australian Wheat Board, and the Australian Sugar Board – had come under increasing scrutiny. These STEs, like China's massive state-owned enterprises today, were seen as causing economic distortion in the industries they dominated. The Uruguay Round of the GATT (General Agreement on Tariffs and Trade) singled out state trading enterprises for elimination after the pact took effect in 1995.

Fonterra: an unreformed STE

New Zealand resisted change and only superficially reformed its STE in 2001, when Fonterra was created through the merger of NZDB with the country's two largest dairy co-ops, Kiwi Co-operative Dairies and New Zealand Dairy Group. Although two smaller co-ops remained independent, Fonterra retained control of almost all New Zealand dairy exports, conducting business as usual as a near-monopoly exporter.

MPCs: Kiwi Tariff-Evading Stealth Weapon

As U.S. trade negotiators were throwing dairy farmers overboard in 1994, New Zealand was busy creating a big loophole for Milk Protein Concentrates (MPCs) in the Uruguay Round agreement. MPCs were a brand new dairy product category that NZDB had apparently designed to evade the weak import restrictions in the new trade agreement. Boatloads of MPC imports from New Zealand – subject to virtually zero tariffs – soon became a cheap substitute for U.S. raw milk supplies in making cheese, yogurt, and other dairy products. MPCs were "a dream come true" for Kraft Foods and other big dairy processors seeking lower input costs to maximize their profits – and a triumph for NZDB/Fonterra. More to come on New Zealand's sordid MPC dumping next month!

Fonterra inherited NZDB's aggressive business model and extensive global network of subsidiaries and alliances. Despite the "reforms," Fonterra continues many of its predecessor's most egregious vices noted above. And, with New Zealanders firmly entrenched in key positions (see below) at the World Trade Organization– the Uruguay Round's successor – enforcement of STE reforms has been lax, at least for dairy.

Fonterra vital to NZ economy

New Zealand's government works so hard to advance Fonterra's interests because dairy is so vital to the national economy. Fonterra is New Zealand's largest company and its dairy exports are the leading source of foreign currency. According to official data, New Zealand's 2012 dairy exports totaled US$9.75 billion, equal to 25.7% of total annual NZ merchandise exports that year. Exports of milk powder, butter, cheese, casein, and caseinates totaled 8.62% of New Zealand's real gross national product of US$113.24 billion in 2012.

Fonterra's 2012 annual report listed 10,578 farmer members and 17,300 employees worldwide, with 36% based outside New Zealand. According to its Web site (www.fonterra.com), "We ranked fourth in Rabobank's 2012 Global Dairy Top 20 report with a turnover of US$15.7 billion – behind Nestlé at US$25.9 billion, Danone at US$19.5 billion and Lactalis at US$18.8 billion." Wikipedia reports Fonterra's annual turnover at "around US$17 billion," about half again as big as annual revenues at Dairy Farmers of America, the largest U.S. dairy co-op.

Global networks

Fonterra's global network extends like a web across five continents, with the hungry spider in control at the center, in New Zealand. Its subsidiaries operate in over 100 countries (some estimates are as high as 140). Its business units operate in many milk-producing nations, which Fonterra has in effect colonized to extract vast wealth by processing local milk supplies, which are blended with New Zealand ingredients and then marketed either locally or globally.

Fonterra operates out of five locations in Latin America (two offices and a site in Brazil, plus offices in Venezuela and Mexico) and further penetrates Latin American markets through its Dairy Partners Americas (DPA) venture with Nestlé . DPA processes 6.816 billion pounds of milk per year.

Fonterra's Soprole subsidiary in Chile produces cheese, butter, fluid milk, and processes 1.136 billion pounds of milk annually. Soprole is one of four large firms that control 76% of Chile's dairy market.

"In Latin America, our Soprole business is a leader in consumer dairy in Chile with the number one or two positions across all major categories. Our joint venture with Nestlé, Dairy Partners Americas, provides consumer dairy products across Brazil, Venezuela, Ecuador, Argentina and Columbia," Fonterra said on its Web site.

Free Trade alliances

To advance its trade policy goals, Fonterra is a founding member of the Cairns Group, a diverse collection of 19 agricultural exporting countries on five continents pushing for free trade. Members account for 25% of global farm commodity exports. The Cairns Group was formed in 1986 as the Uruguay Round talks began, with the goal of countering agricultural supports and export subsidies in Europe and the U.S.

Another key forum is the Global Dairy Alliance (GDA). The GDA, which includes New Zealand, Australia, Argentina, Brazil, Chile, and Uruguay, was formed a decade ago, after completion of the Uruguay Round to push for further trade reforms. GDA's goals include "Substantial, progressive improvements in market access for dairy products leading ultimately to the elimination of all dairy product tariffs and tariff quotas," which would eliminate remaining U.S. dairy import barriers. GDA also seeks the elimination of export subsidies, export credits, and foreign food aid programs.

Argentina, Brazil, and Chile, where Fonterra has subsidiaries or joint ventures, work with New Zealand to promote free trade as members of the Cairns Group and the Global Dairy Alliance.

Free trade for U.S. dairy farmers

In the U.S. – where National Milk Producers Federation and International Dairy Foods Association helped NZDB/Fonterra sell dairy leaders on the virtues of free trade – the big co-ops quickly lined up for the benefits. With the World Trade Organization in place as of 1995, many dairy leaders actually believed their own propaganda – that they could out-compete anyone, anywhere, even New Zealand. Fast-forward a decade later: The promised global markets eventually arrived, but only after Fonterra had sewed up everything for itself through joint ventures and other clever wealth-extraction schemes.

The early fruits of free trade came as NMPF member co-ops eagerly formed joint ventures and marketing pacts with Fonterra, as detailed below. Those benefits tilted heavily in New Zealand's favor, as Fonterra's bottom line would soon reveal.

52% profit margin on U.S. operations

The U.S. market has been a gold mine for New Zealand in the WTO era, with Fonterra extracting huge profits through its subsidiaries and joint venture operations here in recent years. As previously reported by *The Milkweed*, **Fonterra's U.S. operations reported a net profit of US$1.3 billion in 2008, equal to a 52% return on revenues of US$2.5 billion.** And, there's even more to come, according to a June 9, 2008 *The New Zealand Herald* news story quoting Fonterra USA President Martin Bates: "I can easily see that we can double that business in three to five years."

In contrast, DFA – Fonterra's bumbling joint venture partner – reported huge losses of $108 million in 2008. With Fonterra extracting such huge profits from the U.S. market, it's easy to why so many dairy farmers here were facing financial ruin. **Fonterra's profits coincided with the big milk powder price under-reporting scandal in 2006-2007 that cost U.S. dairy producers as much as $1 billion in lost income. *The Milkweed*, which exposed the milk**

Far Beyond Recent Botulism Scandal

powder price reporting scandal, estimated that the lost income averaged about $10,000 per farm. Fonterra was (and remains) the exclusive milk powder export agent for DairyAmerica, the marketing cartel of U.S. dairy co-ops involved in that price-reporting fiasco.

U.S. joint ventures heavily favor Fonterra

Fonterra's joint ventures in the U.S. are consistent with the predatory behaviors long cited by dairy traders familiar with the Kiwi "grab and hold" business model.

Once the honeymoon is over and the market is penetrated, the Kiwis either squeeze their domestic partners for all they're worth, or shove them over and take full control of the venture.

That pattern holds in the case of Fonterra's two key U.S. joint ventures, DairiConcepts and DairyAmerica. These joint ventures provide Fonterra with the best of both worlds – suppressing competition from its naïve U.S. business partners while raking in the profits for itself. Fonterra uses its DairiConcepts joint venture with partner Dairy Farmers of America as a platform to import New Zealand cheese and dairy ingredients. New Zealand products are imported and processed at nine U.S. manufacturing plants, and in some cases blended with U.S. products for distribution here.

(**Editor's note:** Industry sources tell *The Milkweed* that DFA's Borden Cheese processed cheese products are heavily laden with cheese shipped from New Zealand. DFA holds many cheese import licenses.)

DairiConcepts is an ideal arrangement for the time being, as New Zealand trade negotiators work to eliminate Tariff-Rate Quotas, the remaining U.S. dairy import barriers to Fonterra's products. Under certain free trade "rules of origin," once an imported product is processed, blended or otherwise transformed in the U.S. – voila! – it magically becomes a domestic product made in the USA. Problem solved!

Consistent with the Fonterra business model, the DairiConcepts joint venture is heavily tilted in New Zealand's favor. Several years ago, *The Milkweed* reported that Fonterra assumes only 10% of the risk while splitting the profits 50-50 with DFA, which assumes 90% of the risk.

DairyAmerica is a similarly tilted business venture with a marketing cartel of four U.S. milk-powder producing co-ops that hired Fonterra as the exclusive agent to market 100% of their nonfat dry milk powder. DairyAmerica's members include California Dairies Inc., Agri-Mark, Inc., O-AT-KA Milk Producers, Inc., and United Dairymen of Arizona.

DairyAmerica is an ideal arrangement for New Zealand. Fonterra controls the marketing of a major competitor's milk powder exports and keeps the profits for itself. This is another case of Fonterra taking the gold and giving U.S. farmers the mine shaft. Milk powder prices are consistently lower in the U.S. than on global markets, even with Fonterra doing the export marketing.

"Powdergate" scandal

Kiwi Co-operative Dairies, one of the three large entities that merged into Fonterra, was mired in the "Powdergate" scandal that exploded in 2001. According to press reports, Kiwi Dairies officials illegally exported some 10,000 tons of substandard milk powders in various shipments with a combined value of $75 million between 1999 and 2001. Under the scams, substandard New Zealand milk powders were illegally exported for use as a "human grade" food product. Some of these products, originally labeled for use as industrial adhesive ("glues") were processed into food products in the U.S. A shipment of this substandard New Zealand milk powder was stored at a warehouse near Madison Wisconsin and was used to produce imitation cheese.

Kiwis dominate WTO ag chair

New Zealand has further tilted the global trade playing field to Fonterra's advantage through the Kiwis' firm control of the WTO agriculture negotiations for the past decade. Four New Zealanders have served consecutive terms as chairman of the WTO Agriculture Committee since 2003. The current Ag Committee chairman is NZ Ambassador John Adank, who assumed the post in 2011. Andank replaced fellow Kiwi David Walker, who chaired the agriculture negotiations beginning in 2009. Prior to Walker, the chair was held by the current New Zealand Trade Minister Tim Groser (2003-2005) and Crawford Falconer (2005-2009). With New Zealanders repeatedly monopolizing the top agriculture slot at the WTO, it's no surprise that Fonterra can do no wrong in the eyes of the global trade cops.

Friends of NZ Congressional Caucus

Fonterra benefits from the support of the Friends of New Zealand Congressional Caucus in the U.S. House. The bipartisan caucus, which currently lists 51 members in the 112th Congress, works "to strengthen the economic, political, and social links between the United States and New Zealand." Established in 2005, the caucus is now co-chaired by Reps. Kevin Brady (R-TX) and Rick Larsen (D-WA).

The House caucus works closely with the U.S.-New Zealand Council, a private industry support group, to advance "the goals of the Trans-Pacific Partnership (TPP) trade negotiations." The TPP, a controversial regional free trade proposal supported by the Obama administration, includes New Zealand as a key participant. With the WTO Doha Development Round talks stalled indefinitely, the Kiwis are building support for the TPP in Congress as an alternative route to gain full access to the U.S. dairy market.

The TPP is so toxic to U.S. dairy farmers' interests that even the "free traders" at NMPF have not dared to support it … at least not publicly. Despite the obvious risks to U.S. dairy farmers, the Friends of New Zealand Congressional Caucus includes two Midwest Republicans with sizeable numbers of dairy farmers in their House districts: Tom Petri of Wisconsin and Donald Manzullo of Illinois. Some observers refer to this House caucus as Fonterra's "Shills on Capitol Hill."

The U.S.-New Zealand Council "outed" National Milk's close ties to Fonterra by honoring longtime NMPF board chairman Tom Camerlo – who also was board chairman of DFA and U.S. Dairy Export Council – as a "special friend" of New Zealand prior to his death in late 2009.

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My Introduction to the NZDB

by Jim Eichstadt

I became acquainted with the New Zealand Dairy Board in early October 1993, when I was invited to meet NZ Ambassador John Wood at a reception in Madison hosted by the Wisconsin Farm Bureau Federation. The Kiwi delegation was unusually friendly, with much back slapping and insincere flattery directed at the Wisconsin dairy co-op leaders and Farm Bureau officials attending the event.

My interest in meeting the New Zealand group was piqued by two successful international trade skirmishes I had taken part in a year earlier – the Goya cheese war and an Emmentaler cheese price undercutting complaint against Switzerland. Industry sources had cautioned that the NZDB – despite New Zealand's small size – was a particularly ruthless and unscrupulous competitor in the global markets of that era. I was curious to learn more about these fierce Kiwis.

Accompanying the ambassador was an NZDB official named Fiona Cooper. Ambassador Wood and Ms. Cooper went to great lengths to reassure their Wisconsin audience that New Zealand was U.S. dairy farmers' "natural allies and friends." The delegation put on an impressive show, repeatedly reassuring their hosts that "We want to work with you … Together we can supply the growing world market … We're no bigger than Wisconsin … and "How could we possibly be a threat?" It all sounded so good at the time – too good to be true.

Kiwi Charm Offensive

Many at the Madison reception were impressed with the smooth New Zealand sales pitch, which in reality was a sideshow intended to grease the skids for truly unpleasant things to come one year later – the elimination of U.S. dairy import quotas. The Kiwi charm offensive was part of a broader strategic push for radical trade "reforms" NZDB was seeking through the Uruguay Round negotiations, which were then moving toward their 1994 conclusion in Geneva. The New Zealanders understood that they needed to win domestic allies and neutralize potential foes if they were to make progress toward their audacious goal of complete, unfettered access to the lucrative U.S. dairy market.

Without adequate political cover from domestic dairy leaders (and encouragement from NZDB lobbyists' big campaign contributions), Congress might never have passed highly controversial 1994 legislation implementing the Uruguay Round. This very bitter medicine included provisions to dismantle vital U.S. Section 22 import quotas protecting producers of dairy and other key farm commodities from a flood of cheap imports.

NMPF board chairman James P. "Tom" Camerlo was a top dairy advisor to U.S. trade negotiators in 1994, when critical decisions were made to sacrifice U.S. dairy protections at the Uruguay Round. Camerlo was a member of the elite Presidential Advisory Committee on Trade Policy and Negotiations, the top group of industry experts appointed to advise the White House on U.S. trade priorities. Camerlo later served as board chairman of DFA and the U.S. Dairy Export Council.

The Kiwi scheme was clever – and it worked perfectly! While limited U.S. dairy trade barriers still remain – in the form of Tariff-Rate Quotas (TRQs) that replaced Section 22 quotas under the World Trade Organization – New Zealand won a major battle in the ongoing war. Fonterra continues that work on many levels to eliminate the remaining barriers.

The Revolving Door

Fiona Cooper, the NZDB staffer who accompanied NZ Ambassador John Wood at the 1992 reception in Madison, was a typical Kiwi dairy careerist. Two years later, when I encountered Ms. Cooper at a NZ Embassy function in Washington, she was shilling for NZDB with a different hat – as a government official. She, like many of her colleagues, spent much of her career moving through the revolving door, rotating between positions at NZDB/Fonterra, the Embassy in Washington, and government posts in Wellington, New Zealand.

Fonterra's revolving door reminds me of the incestuous relationship between the National Cattlemen's Beef Association and USDA. The "revolving door" doesn't promote good government. Many top officials of the NCBA, a conservative cattle industry lobbying entity funded in large part by beef checkoff dollars, hold key positions at the highest levels of USDA. Many of these folks are Reagan and Bush-era political appointees who managed to get themselves grandfathered in as career civil servants before Democrats took control of the White House in 1992 and again in 2008.