

Fonterra's Long Tentacles Linked to U.S. Dairy Woes

by Pete Hardin

Some of the worst elements of America's tangled dairy mess can be traced to the treacherous tentacles an overseas monster – New Zealand's Fonterra. Formerly known as the New Zealand Dairy Board (NZDB), Fonterra Co-operative Group is the world's largest and most aggressive dairy exporter. Like the NZDB, Fonterra has an insatiable appetite for unlimited access to U.S. dairy markets and will do anything to get its way. Fonterra and its vast global network of subsidiaries and joint venture partners ... including some of the biggest the U.S. co-ops ... have their fingerprints on dairy's worst offenses.

On the surface, Fonterra appears – and claims – to be just another large dairy processor/exporter competing in a global market where the big co-ops and multinational corporations have become virtually indistinguishable in recent years. What makes Fonterra lethal – and sets it apart from the Krafts, Nestlé's and Groupe Danones of the world – is the combination of its ruthless *Exports über Alles* mentality and the monopolistic DNA retained intact from the NZDB's past life as a State Trading Enterprise.

Fonterra, formed in 2001 through the merger of NZDB and New Zealand's two largest dairy co-ops, currently claims 10,537 dairy farmer "shareholders" and 15,600 employees. The entity, headquartered in Auckland, exports 95% of New Zealand's milk production and controls nearly 40% of global dairy trade. "Our global supply chain stretches from farms all over New Zealand to customers and consumers in more than 140 countries," according to its Web site, www.fonterra.com. That global supply chain exists to export a wide range of NZ dairy products, including Milk Protein Concentrates, casein, and caseinates to the U.S. and many other markets. Many American dairy farmers correctly blame cheap MPC imports for the deep depression in farm milk prices.

Obscene profits, bigger plans

The February 2010 issue of *The Milkweed* took a hard look at the obscene profits generated by Fonterra's U.S. operations. A key point emphasized last month bears repeating because it is so powerful: **Fonterra's U.S. business operations generated an incredible \$1.3 billion in profits on \$2.5 billion in annual revenues (both figures in U.S. dollars).** That news, reported in the June 9, 2008 edition of *The New Zealand Herald*, cited numbers provided by Martin Bates, president of Fonterra USA.

But wait: there's more! The same article quoted Fonterra USA's Bates as stating: **"I can easily see that we can double that business in three to five years."** (Emphasis added.) Recent, ongoing expansion of Fonterra's milk processing capacity promises to make that prediction a reality.

That incredible 52% profit margin – with much more anticipated – sharply contrasts with many in the U.S. dairy industry struggling to survive on razor-thin (or negative) margins. Any American dairy firm enjoying that kind of profit margin in these hard times would ... and should ... be under intense scrutiny from every antitrust lawyer and elected official in the country. Imagine the public outrage if dairy farmers were reported gouging consumers with 52% profit margins!

This month we focus on other key aspects of Fonterra which make it such a lethal threat to America's struggling family dairy farmers and, ultimately, to our nation food security in the form of adequate supplies of domestic milk, cheese and other dairy products.

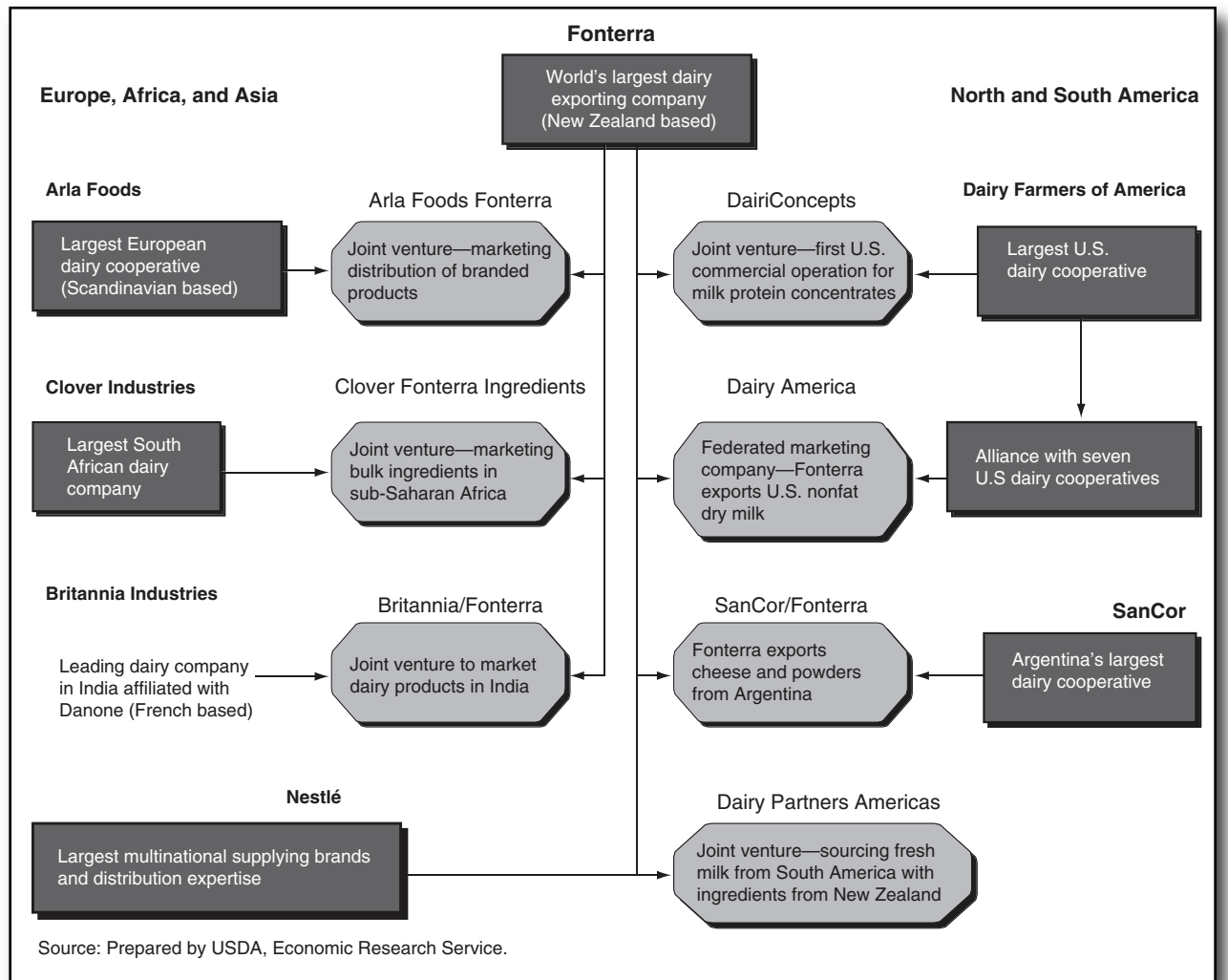
Fonterra's cutthroat marketing practices and expanding global marketing and processing network raise many red flags about preserving viable family dairy farms in America. As New Zealand's hunger for the American dairy market has grown, concerns about Fonterra have expanded far beyond trade issues:

* Fonterra has raised antitrust concerns at the U.S. Department of Justice (DOJ).

* The Internal Revenue Service is concerned about federal income tax evasion through Fonterra's transnational structure.

* New Zealand officials dominate global trade talks on agriculture.

* The NZ Government provides outsized political support for Fonterra.



* Fonterra's ability to manipulate the political process in Washington is unparalleled in the dairy industry.

Unreformed STE controls global network

Casual observers might question why two small islands in the South Pacific, with fewer dairy farmers than Wisconsin, poses such a menace to dairy farmers in the U.S. This reality is not the case of the elephant being scared of the mouse, however. Part of the problem lies in the fact that New Zealand's pasture-based dairy farms have perhaps the lowest milk production costs in the world, lower than India and Poland. The biggest part of the problem lies in the ruthless and predatory manner in which Fonterra exports dairy products made from that lost-cost milk.

Credit much of the concern to Fonterra's unique business model as near-monopoly exporter whose behavior is virtually identical to that of its predecessor, the NZDB. As noted in last month's issue of *The Milkweed*, the so-called dairy "reforms" of 2001 were mere window dressing to hide the reality that Fonterra continues to operate unchecked and unchallenged as a near-monopoly exporter despite World Trade Organization prohibitions against STE-like behavior.

According to the NZ Ministry of Agriculture and Forestry, "Fonterra has a wide range of international marketing subsidiaries, joint ventures and other arrangements, including in the US (with Dairy Farmers of America), North and Latin Americas (with Nestlé), in the UK and Europe (with Arla Foods) and in India (with Britannia Industries)."

A 2006 report by USDA's Economic Research Service (*U.S. Dairy at a Global Crossroads / ERR-28*) includes a flow chart illustrating Fonterra's global network, which covers the U.S., Mexico, Chile, Australia, India, the United Kingdom, Scandinavia, South Africa, Argentina, Venezuela, and other countries. (See chart, this page.)

Growing demand for dairy products in China, India and other developing countries threatens to outpace Fonterra's ability to supply that demand with homegrown milk supply. To meet that demand, Fonterra has established a global web of dairy processing and marketing joint ventures (in effect, "colonies") in the U.S. and other countries listed above. This global network, inherited in part from the NZDB, allows Fonterra to control and profit from captive foreign milk production as the "middleman" in trade deals.

The foreign "colonies" also allow the Kiwis to play games with global trading rules, such as blending New Zealand milk products with local milk products at processing plants in the colonized country to skirt "rules of origin" on exports to the U.S. and other partially-restricted markets.

Joint ventures harm ALL U.S. farmers

The offshore processing entities allow Fonterra to expand its market share beyond New Zealand's own milk production limits while skimming the profits from milk producers in the host countries. American dairy farmers have felt the "benefits" of one such partnership with New Zealand – DairyAmerica, the milk powder marketing cartel of nine farmer-owned co-ops that hired Fonterra as its exclusive export agent. According to 2007 data from USDA's National Agricultural Statistics Service (NASS), DairyAmerica lost \$.36 per pound on milk powder exported by Fonterra.

Ultimately, all U.S. dairy farmers got screwed by the Fonterra deal. The improper reporting of DairyAmerica's lowball, long-term milk powder contracts to NASS threw a monkey wrench in federal milk order product pricing formulas for many months, costing American dairy farmers millions in losses.

Antitrust concerns raised

Thanks to a new mind-set in the Obama White House, federal antitrust regulators finally appear to have dropped the George W. Bush administration's "see no evil" mindset toward market concentration. Fonterra may soon join dairy's other leading suspects – including its joint-venture partner Dairy Farmers of America and Dean Foods – under the antitrust scrutiny of a reinvigorated DOJ.

Despite the alarms being triggered at the DOJ's Antitrust Division, some tone-deaf officials within the White House are pushing the Trans Pacific Partnership – a proposed regional trading bloc that could bring "Free Trade" involving dairy products with New Zealand.

Transfer Pricing = Tax Cheating

Fonterra's global network of subsidiaries allows it to engage in an illegal practice called "transfer pricing," a tax-evasion shell game in which profits are hidden by accounting tricks and other bookkeeping schemes between global corporations and their local subsidiaries. Transnational firms use elaborate, intra-company transactions to shift the profits generated by their U.S. business units to corporation entities located in the home country or other countries with much lower tax rates.

IRS officials have come to view transfer pricing as a major source of tax fraud. The GATT Uruguay Round Agreement implemented in 1995 opened up many opportunities for transnationals to unduly profit – in dairy and other sectors. Sources earlier this decade estimated that the U.S. Treasury had been cheated out of hundreds of millions of dollars annually in dairy alone.

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Kiwis dominate WTO ag talks

Fonterra's role in pushing "Free Trade" is enhanced by the fact that prominent New Zealand officials have dominated the ongoing WTO Doha Development Round agriculture talks since 2003. The current chair of the WTO negotiations on agriculture is David Walker, a Kiwi official who assumed the job on April 22, 2009. As noted on the WTO Web site: "Ambassador Walker is the third New Zealand ambassador to chair the agriculture negotiations, after Tim Groser (2003-2005, now New Zealand trade minister) and Crawford Falconer (2005-2009)." See http://www.wto.org/english/news_e/news09_e/agng_22apr09_e.htm

Fonterra has an unfair advantage with Walker and the previous two NZ "umpires" calling the game at WTO headquarters in Geneva. Perhaps that's one reason why Fonterra remains invisible on the trade bureaucrats' radar screens.

NZ gov't. serves as Fonterra's iron fist

Much credit also goes to Fonterra's intricate political support network, which is unparalleled by its major trading rivals. From the Prime Minister's office on down, the Government in Wellington and embassies around the world function as an iron-fisted extension of Fonterra, eager to advance the interests of New Zealand's largest industry and exporter. The Kiwis have perfected the "revolving door" concept as top officials rotate between jobs at Fonterra's headquarters and key government posts in Welling-

ton and New Zealand's Washington embassy.

This coordinated, muscular political support network, courtesy of New Zealand taxpayers, is a very large, unfair and stealthy subsidy to Fonterra that so far has evaded detection by WTO trade bureaucrats in Geneva. How can that be?

Huge Washington lobbying presence

Then there's Fonterra's skill in manipulating adversaries naïve enough to believe its rhetoric about "Free Trade." With the NZ Ambassador and Embassy staff guarding its flanks in Washington, D.C. Fonterra maintains an army of high-priced lawyers to lobby for its interests in the halls of Congress and before federal agencies in Washington, D.C.

The Kiwis' lobbyists over the years have included the extremely well-connected (Clayton Yeutter, the former Secretary of Agriculture and U.S. Trade Representative under the Reagan and George H.W. Bush administrations) and some goons (former congressional Capitol Hill staffers with checkered pasts).

Fonterra USA is such a formidable foe in Congress and other Washington power centers because it routinely outspends and outmaneuvers incompetent U.S. dairy groups like National Milk Producers Federation. Even its occasional allies at International Dairy Foods Assn. and Cheese Imports Assn. of America have good cause to watch their backs with Fonterra.

Further, the Kiwis have cultivated (and seduced) a fine flock of gullible U.S. dairy co-op

leaders as collaborators. The late Tom Camerlo, past NMPF and DFA chairman, was honored by the U.S.-New Zealand Council as having a "very special relationship" with New Zealand at the June 2008 ribbon-cutting ceremony at Fonterra USA's fancy new headquarters in Rosemont, Illinois (a move assisted by \$1.15 million in public financing provided of the State of Illinois).

Friends of NZ Caucus: "Shills on the Hill"

Fonterra maintains a group of 63 supportive House members in the 111th Congress through the Friends of NZ Congressional Caucus. The U.S.-New Zealand Council describes the caucus as "a bipartisan working group that works to strengthen the economic, political, and social links between the United States and New Zealand ..." Among the New Zealand shills on Capitol Hill are Republicans Tom Petri of Wisconsin and Donald Manzullo of Illinois, both of whom represent large numbers of dairy farmers in their House districts.

One veteran observer on described the Caucus as "a legislative sleeper cell awaiting instructions from Wellington" to march in support of "Free Trade" with New Zealand. Prominent members include House Democratic Majority Whip Steny Hoyer of Maryland. With President Obama's interest in negotiating the Trans Pacific Partnership trade pact with a group of nations including New Zealand, the "Caucus" may soon have a chance to fulfill its mission.