

The Chair

Senate Inquiry into Milk Prices

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Dear Sir

I understand that the closing date for submissions was 28 February 2011, I would like to make a late submission as I have made extensive studies of the dairy industry.

In 2008 on behalf of some dairy farmer clients we made these submissions to the ACCC Inquiry into Retail Grocery Prices. The first was made and evidence given, in part, on the lack of competition for farm gate milk prices and other anti-competitive forces affecting or likely to affect the dairy industry. The second was a supplementary submission was made at the request of the Chairman of the Inquiry, Mr Samuel, which dealt with changes in the dairy industry since deregulation. Mr Samuel had earlier been chair of the National Competition Council which had recommended deregulation of the dairy industry.

Both these submissions are attached and I also refer the committee to some of the conclusions made, often without recommendation, of that inquiry on supply chains, buyer power and vertical relationships. Since then there has been further concentrations of ownership in the processing sector.

I would be pleased to elaborate on these should the committee so desire.

I am making this submission on my behalf and not that of the group for which I had worked in preparing the earlier submissions.

Yours sincerely

Geoffrey Quinn

Public submission by Kiama Shellharbour Albion Park Milk Suppliers Collective Bargaining Group

Date: 11 March 2008

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Introduction

It is our submission that in certain parts of Australia the dairy industry is adversely affected by the conduct of processors and food retailers inasmuch that there is:

- ◆ A lack of competition in some markets
- ◆ Natural monopolies exist
- ◆ Incomplete markets exist
- ◆ A lack of price transparency
- ◆ The industry is, in part, susceptible to abuses in market power
- ◆ The existence of cartel behaviour
- ◆ Under investment in innovation and new ideas across all sections of the industry, and
- ◆ Constraints to productivity growth.

In this submission we believe that most of the foregoing falls within the range of sections G & H of the ACCC's Issues Paper.

We submit that the foregoing acts to the detriment of true competition and that this is decidedly at an ultimate cost to consumers but to the benefit of processors and major retailers.

Our submission addresses each of these factors and where relevant we suggest possible remedies with the aim to improve competition; improve investment in innovation and capacity across the whole of the Australian dairy industry to the ultimate benefit of all sectors in the supply chain and specifically consumers.

Background

First it is necessary to understand the way in which the domestic dairy industry operates. Rather than a single market the Australian dairy industry has a number of separate and discrete markets. These markets are regionally based and can be described as:

- ◆ Northern Australia – Cairns to the Kimberly
- ◆ Central Queensland – based around Rockhampton
- ◆ South East Queensland & North East NSW – Noosa to Grafton
- ◆ Central NSW – incorporating Sydney, Newcastle, Wollongong and the Central West
- ◆ Southern NSW, Victoria and South Australia
- ◆ Tasmania, and
- ◆ Western Australia

In terms of each of these markets or sub markets of the Australian whole we make these comments.

In terms of our submission on aspects of the domestic market for dairy products we are concerned about the conduct of two main processors namely National Foods Limited (NFL) and Dairy Farmers Group (DFG) other market participants are Pauls Parmalat Limited (PPL)

and Norco Cooperative Limited (Norco). None of these processing companies have a significant presence in export markets.

Northern Australia – Cairns to the Kimberly

This is a natural monopoly in terms of processing. The one processor is DFG processes and also packs milk products from milk produced on the Atherton Tablelands for NFL. These products are distributed across the north of the continent as far as Kununurra. All milk producers are on contact to DFG.

Central Queensland – based around Rockhampton

This too serves as a natural monopoly based in Central Queensland and serves the middle of the Queensland coast and the western inland areas of the state. PPL operates the processing plant and it is understood does some brand processing for other processors. All milk producers are on contract to PPL.

South East Queensland & North East NSW – Noosa to Grafton

This is the fastest growing market in Australia with growth at approximately four percent a year. There are four processors operating in this market namely PPL, DFG, NFL and Norco.

It presents an interesting situation inasmuch that there are frequent supply shortages. These shortages are due to the contraction of the number of producers both by number and volume. The main period of shortage occurs seasonally from about March to May.

Two things occur to alleviate this shortage. Firstly, milk is carted from Victoria and Southern NSW at approximately 16¢ per litre in freight costs. Secondly, there is the addition of a liquid by-product of cheese manufacture known as permeate which is added to packaged milk. This too is purchased at about 1¢ per litre and carried for 16¢ per litre from Victoria. Permeate is added to milk at up to 12 percent; the rationale used is that it standardises the fat and protein content of the milk. In reality we suspect it waters down the milk.

For 100 litres of milk containing 12 per cent permeate the calculation is:

Farm-gate price of milk 45¢ per litre per 88 litres	=	39.60
Permeate at 17¢ per litre per 12 litres	=	<u>2.04</u>
Net value per litre ¢		<u>41.64</u>

This is a discounted value on the farm gate milk price of 7.5 percent with all of the benefits being taken either by retailers or processors to the detriment of both producers and consumers.

This represents a significant discount on the farm gate price of milk and amounts to a passing back up the supply chain of costs compared to the profits derived by both processors and retailers. This has allowed for so called discounting of milk especially by retailers private brands. Another possible outcome of the addition of permeate is a reduction in shelf life of milk.

We understand that only one of the four processors in this market has resisted the pressure to add permeate to milk. We submit that the ACCC may wish to investigate the efficacy of this assertion.

Processor-to-processor dealings are also effectively resulting in a secondary milk market.

In addition PPL as part of its collective bargaining group has a system of quotas. That is the right to produce and sell a given volume of milk at a certain price. Farmer suppliers who do not hold a quota receive a lower price. This system acts a restraint to trade, encourages rent seeking and serves to drive costs up. This is a carry over of regulation and serves to diminish competition with resultant supply chain ramifications.

Central NSW – incorporating Sydney, Newcastle, Wollongong and the Central West

This is the largest domestic market in Australia and it too has similar seasonal supply problems to the market immediately to the north. We understand similar conditions exist in terms of the processing and marketing of dairy products. The two major processors in this market are NFL and DFG. The two dominant retailers are Coles and Woolworths. It is understood permeate is also added by processors to milk for sale in NSW. We submit that the ACCC may wish to investigate the efficacy of this assertion.

Again secondary milk markets occur in this market through processor-to-processor dealings.

Southern NSW, Victoria and South Australia

This region is the epicentre of the Australian dairy industry with more than 70 percent of production occurring here. Most of the milk produced in this region is for processed exports. The area services the domestic markets of Melbourne and southern regional cities as well as Adelaide.

Dominant processors in this market are DFG, NFL, PPL and Murray Goulburn (MG). The predominant retailers are Coles and Safeway.

Tasmania

Most of the milk produced in the state is also destined for the export market.

Western Australia

This is an isolated market and has its own unique production and market problems.

General

National dairy production is 9.6 billion litres, of this 2 billion litres are consumed as drinking milk, the rest is manufactured into other milk products, being cheese, powders, yogurts, ice cream and other products. Domestic consumption accounts for 48 percent of total production and exports 52 percent. Consequently overseas commodity prices are always a significant factor in domestic pricing as are exchange rates.

A lack of competition in some markets

As described earlier the least competitive markets in Australia are those based around the capital cities of Brisbane and Sydney. This is due to a combination of circumstances, being:

- ◆ The exercise of market power by major retailers
- ◆ Cartel behaviour
- ◆ Inadequate price signals, and
- ◆ Diminished farm-gate competition for supplies.

These issues are addressed below.

Natural monopolies occur

We have dealt earlier with the existence of natural monopolies and they are by essence caused though isolation and distance and comparatively small population and consequent demand.

Incomplete markets exist

The contracts that processors offer are short term either being one, two or three years and have most having onerous conditions attached to them.

Domestic processors in order to coordinate their activities and to share their risks are prone to undertake opportunistic behaviour and thus to trade sequentially and to make only limited contractual commitments into the future with their suppliers. Frequently this is forced by their short term view of markets and the consequent imperfections in predictions and their

knowledge of other factors impacting upon the market. This is leading to producers refraining from investing in new ideas and innovations and hence capturing productivity gains.

Suggested remedy: Monitor contracts as to:

- ◆ Terms and conditions
- ◆ The removal of onerous conditions
- ◆ Each processor must file with ACCC an approved version and only use that contract,
- ◆ The open publication of prices in standard cents per litre format.
- ◆ Allow for tradable contracts by time and volume.

A lack of price transparency

Some processors through their contract terms and conditions require absolute secrecy and include sanctions in their contracts for disclosure even after the contract supply conditions have been met.

They also go to considerable lengths to not disclose prices as they misuse the term commercial-in-confidence. This leads to price asymmetry and consequent upon this under investment in innovation and expansion of productive capacity.

Suggested remedies: Monitoring, collection and publication by Dairy Australia on a seasonal basis of all price agreements and price ranges offered by processors by region. Also the publication of retail sales of milk and dairy products by volume and price.

Arrangements involving synergies and economies of scope along with competitive tendering by carriers for coordinated milk collection and delivery will save up to 3-4¢ per litre by synergies and competitive tendering by carriers for milk collection and delivery. This would require some standardisation of milk quality definitions – as to fat and protein – and also the penalties that relate to milk quality – namely somatic and bacterial cell counts, antibiotic content and also chemical residues. These efficiency gains distributed along the supply chain will flow through and benefit consumers. However, it will be necessary to have common quality standards.

The industry is in part susceptible to abuses in market power

The purchasing practices of Coles and Woolworths especially leave a lot to be desired in as much that most of their purchasing in particular markets is by running a Dutch auction. This has the effect of putting price pressure back along the supply chain and frequently this is reflected in depressed farm gate prices. Processors complain that they frequently see the store brand sell for significantly less than their branded products.

Similarly some companies most notably NFL choose not to compete for farm gate supplies but are large operators on secondary milk markets and believe they can purchase cheaper milk from other processors at ‘spot’ prices.

Suggested remedies: there are some significant steps that can be taken to reduce the likelihood of abuses in market power, these are:

- ◆ Introducing truth-in-labelling regulations to disclose processor identity as to who packaged a product. This will make consumers aware of price and quality and provide for them a comparison and awareness of true brand identity. A consequence of this could be to move the prices of store brands and processor brands closer together and then in turn lead to some product differentiation. It should also require the disclosure of additives such as permeate.
- ◆ Retailers should also have to bid by tender for products rather than rely upon undisclosed supply arrangements. In this way firms acting in the market will know if they have lost the opportunity of bidding fairly and squarely.

- ◆ Further the cartel behaviour of Coles and Woolworths particularly should be made to open up to true brand competition by stocking all products for consumer benefit. At present NFL has an exclusive supply arrangement to Woolworths and DFG to Coles. Neither of these retailers stocks much of the other processor's product if they do not have exclusive supply arrangements with them. Such arrangements are uncompetitive and opening up the shelves will give consumers wider choice and often price advantage.
- ◆ Open tendering will go a considerable way to reduction of the cartel conduct. It will increase competition at the farm gate for milk supplies.

The existence of cartel behaviour

Earlier we have referred to cartel behaviour. This exists in particular in the Brisbane and Sydney markets. We refer to processor-to-processor agreements that serve to reduce farm-gate competition. Additionally, there are informal agreements between processors that they will not poach each other's suppliers.

Onerous conditions are often placed in contracts making it difficult and punitive for suppliers to change processor.

Suggested remedy: Producers should be able to have tradable contracts and thereby trade their contracts between processors either in long or short-term tranches of milk volumes.

Under investment in innovation and new ideas across all sections of the industry

The dairy industry since deregulation has been beset by a number of problems. Mainly low export prices; drought; lack of water; high input costs especially in respect fuel, fertiliser and grain prices. It is acknowledged that some of these input costs are externalities in the sense that fuel and some fertilisers are linked to international oil prices and price inflation. The same too applies to the relative competition that the production of bio-fuels has on international grain markets which in turn have in Australia's instance have been exacerbated by drought caused shortages.

The price pressures and lack of price transparency have been significant in preventing market-based adjustments to farm gate prices. This has led to under investment in innovations and the adoption of new ideas and improved production praxis. This has also affected the processing sector – except in the export field – leading to higher costs and inefficient production. Freeing up competition in the domestic market will encourage greater investment in capacity and the delivery of better and improved products to the consumer.

Suggested remedies: Opening up domestic markets to further competition and greater price and transactional transparency.

Constraints to productivity growth

As has been demonstrated in the foregoing we submit that there is a considerable amount that can be done to improve the competitive behaviour for firms in the market. Truly free and open markets with properly conveyed price signals along the supply chain will greatly improve investment in the whole dairy industry with resultant benefits for all. This will lead to greater confidence more equitable returns and thus investment in the inputs required for productivity growth. As present arrangements stand they are acting as a major impediment to productivity growth.

Submitted by: Dr Peter Haertsch OAM, Chairman, Mrs Lynne Strong, Secretary and Mr Geoffrey Quinn, Consultant.

**Supplementary submission to the Australian Competition and
Consumer Commission inquiry into retail grocery prices
by
Kiama Shellharbour Albion Park Milk Suppliers Collective
Bargaining Group
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Supplementary Submission to ACCC Inquiry into Grocery Prices

On the post deregulated dairy industry

At the time of giving our oral evidence to the Commission and following upon questioning by the Commissioners we were invited to make a supplementary submission to the Inquiry particularly in relation to how we had observed and experienced changes in the dairy industry since deregulation, and the consequences arising from it.

In market-based economies tensions will always exist between sectors of the supply chain. Most of these are driven by supply and demand and this of course in turn by the extent of and strength of competition. When imbalances occur this is largely due to the relative strength of participants and the extent to which they are able to exercise market power and extract disproportionate rents. This too is also driven by geographic location, proximity to markets and thus the comparative advantage, particularly for suppliers, in regionally-based markets.

To address the specific questions raised by the Commissioners we explain these as:

- ◆ The relationship of retail prices to farm gate prices
 - Dairy Industry Adjustment Package (DSAP)
 - A snapshot of recent retail whole milk prices
 - Changes in proportion of retailers' and farmers' share of consumer spending
 - CPI and relationship to farm gate prices
 - Average farm gate milk prices and CPI adjusted farm gate prices
- ◆ Changes in dairy farm production, specifically:
 - Number of registered dairy farms
 - On Farm production
 - Cows in milk per farm
 - Milk produced per farm
 - Milk produced per cow
 - Production response
- ◆ Retail dairy product volumes and values
 - Fresh drinking milk
 - UHT milk
 - Yoghurt
 - Cheese
 - Dairy spreads
- ◆ Market supply
- ◆ Supermarket dominance
- ◆ Truth-in-labelling and milk packaging
 - Private (store) labels
 - Use of permeate
 - Farmers' attitudes, and

- Product descriptions

Generally, since deregulation the dairy industry has responded well although:

- ◆ The number of farms has decreased
- ◆ Until this year the farm gate price had either decreased or remained static, it has certainly decreased in real terms when increases in CPI are taken into account, and
- ◆ The overall volume of milk produced has decreased, although nationally this is seen more as a response to drought and drought-caused water and feed shortages, on a regional level such as in Queensland and central NSW this can also be attributed to poor pricing policies by processors and retailers.

On the other hand and notwithstanding the forgoing:

- ◆ The number of cows in milk per farm has increased
- ◆ Volume of milk per cow has increased
- ◆ Volume of milk per farm has risen substantially, and
- ◆ The benefit of these productivity gains have by-and-large been captured by the retail sector and particularly by the larger retailers rather than either farmers or processors.

Relationship of retail prices to farm gate prices

Since the Commission's inquiry into grocery prices commenced we have observed a number of competing and often conflicting claims concerning the proportions of the consumer's dollar value when purchasing milk is in reality apportioned.

To test these claims on 18 April 2008 we observed retail milk prices in a number of supermarkets in Sydney. Two each were stores of the major supermarket chains Coles and Woolworths and two independent supermarkets.¹

Retail prices may vary depending upon the nature, style and type of package and package volume size and brand (variable costs) certain costs are consistent between all units being the farm gate milk price and the 11¢ DSAP² levy on retail sales (fixed non-variable costs).

However, the aggregate value of all retail prices when reduced to a unit value per litre and averaged across all supermarket sales and all brands does offer a comparison whether these are generic store (or house) and/or the processors' owned brands – irrespective of package volume from 300ml (smallest) to 3 litres (largest). This average of all retail prices can be compared as like with like and differences explained.

The farm gate price varies little between processors and can be considered as a constant as is the 11¢ DSAP³ levy the two remaining apportionments are processor's margin and distribution and then the difference in value is attributable to the retailer.

The inevitable conclusion is that that the larger supermarket chains – namely, Coles and Woolworths - are able to extract excessive rents through their market dominance, supply arrangements and a lack of competition either in their sector or in the processing sector. The Sydney market, the largest, is a prime example.

¹ Locations for supermarkets used in liquid drinking milk price comparisons: Woolworths, Westfield Bondi Junction and Town Hall, IGA, Oxford Street, Darlinghurst, Duffy Bros, Oxford Street, Darlinghurst, Coles Bondi Junction and City Express.

² Dairy Structural Adjustment Payment, an 11¢ per litre levy imposed upon retail sales to finance the dairy industry adjustment

³ Dairy Adjustment Authority (DAA) <http://www.daa.gov.au/questions.html> access date 30 April 2008

Dairy Industry Adjustment Package (DSAP)

The Commonwealth Government's DSAP was developed to assist the dairy industry adjust from the previous State-regulated drinking milk arrangements to the commercially focused environment that became effective on 1 July 2000. The program is administered by the Dairy Adjustment Authority (DAA).

The dairy industry sought government support during the adjustment period post deregulation to ensure that uncertainties and short-term declines in income did not destabilise the industry, disrupt supply arrangements and adversely impact on its longer-term growth potential.

The dairy industry adjustment package comprised four programs:

- ◆ The DSAP – allocated \$1.63 billion in payments for eligible dairy producers
- ◆ Supplementary Dairy Assistance - allocated an additional \$139 million in payments
- ◆ The Dairy Exit Program - provided an optional tax-free exit payment of up to \$50,000 for eligible dairy producers wishing to leave the industry, administered by Centreline, and
- ◆ The Dairy Regional Assistance Program – provided \$65 million to assist regional communities to adjust to dairy deregulation.

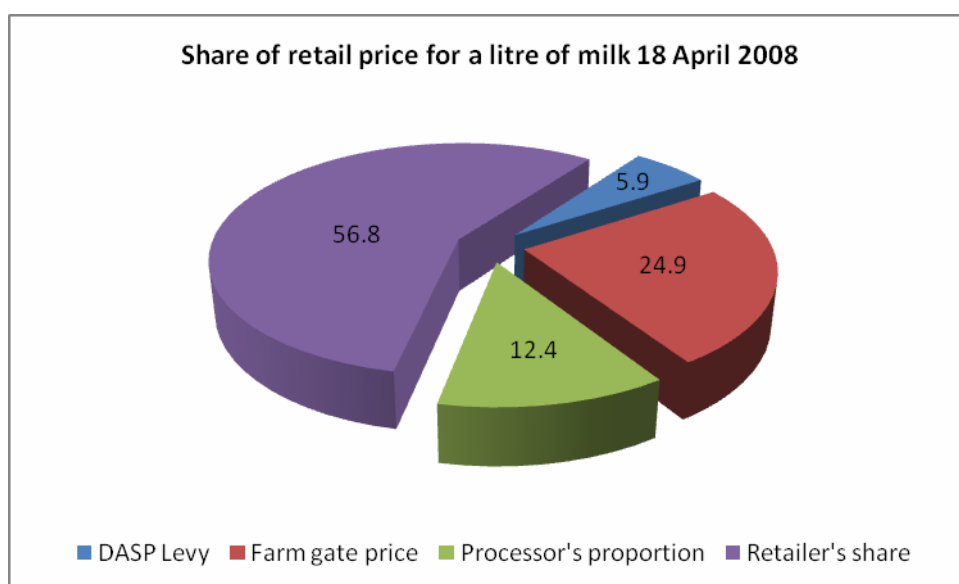
The Government's dairy industry adjustment packages are funded by an 11¢ per litre levy (tax) on retail sales of drinking milk this includes fresh and UHT⁴ milk. This levy is a significant component in retail milk prices and is anticipated to conclude in 2010.

A snapshot of recent retail whole milk prices

On 18 April 2008 we observed retail prices for whole milk in a number of inner city (Sydney CBD) and eastern suburbs supermarkets, the average per litre price for the different package sizes of whole milk was:

	Woolworths <i>\$ per litre</i>	Coles <i>\$ per litre</i>	Independents <i>\$ per litre</i>
1 litre packs	2.08	1.82	2.33
2 litre packs	1.30	2.01	1.74
3 litre packs	1.22	1.48	1.77

The overall average whole milk retail price across all the stores was \$1.88 per litre; it is upon this basis that the proportions of the retail price in Graph 1 are calculated.



Graph 1 Illustrates the proportion of the average retail price of \$1.88 per litre for 1, 1.1, 2 and 3 litre packs of whole fresh drinking milk observed on 18 April 2008 between the major components of the supply chain.

⁴ Ultra High Temperature (UHT) long life milk is generally not refrigerated until opened for use.

A detailed summary by retailer, processor and package size is presented in Tables 1.1 and 1.2 for two (2) litre packs and Tables 1.3 and 1.4 for three (3) litre packs. Tables 1.2 and 1.4 include an estimation of milk '*standardised*' using 10 percent permeate and how these proportions alter.

We are aware that a number of organisations who have, in their submissions, offered varying calculations on which supply chain sector gains most from the consumer dollar, serving to add to perplexity. Specifically we refer to Coles Supermarkets submission prepared by Freshlogic⁵ (p.57) where they illustrate that farmers obtain the largest proportion of retail sales compared to either processors or retailers. We believe that this may be disingenuous as the averages upon which the calculations are based are not quoted and the DSAP levy is not included this appears to be inconsistent with our observations and data provided by Dairy Australia.

⁵ Freshlogic, Report on issues relevant to the ACCC inquiry into the competitiveness of retail prices for standard groceries, Prepared for Coles Supermarkets March 2008

Table 1.1 Snapshot of retail prices for 2 litre milk packs observed in inner Sydney on 18 April 2008 showing dairy processors' brands and supermarkets' private label brands compared to farm-gate prices for raw milk without permeate added

	Woolworths				IGA							
	Home Brand ¹	proportion	Milk ¹	proportion	Pura ²	proportion	Dairy Farmers ⁴	proportion	Pura ²	proportion	Dairy Fresh ²	proportion
	\$	%	\$	%	\$	%	\$	%	\$	%	\$	%
2 litre displayed retail price	2.19		2.59		2.99		3.69		3.99		2.79	
<u>Less</u> DSAP levy 11¢ per litre	0.22	10.05	0.22	8.49	0.22	7.36	0.22	5.96	0.22	5.51	0.22	7.89
Net price after levy	1.97		2.37		2.77		3.47		3.77		2.57	
<u>Less</u> farm gate price 46.8¢ per litre ⁱ	0.94	42.74	0.94	36.14	0.94	31.30	0.94	25.37	0.94	23.46	0.94	33.55
Net margin available to retailers & processors	1.03	47.21	1.43	55.37	1.83	61.34	2.53	68.67	2.83	71.03	1.63	58.57
Total	2.19	100.00	2.59	100.00	2.99	100.00	3.69	100.00	3.99	100.00	2.79	100.00
	Duffy				Coles							
	Dairy Fresh ²	proportion	Pura ²	proportion	Dairy Farmers ⁴	proportion	Coles ³	proportion	Dairy Farmers ⁴	proportion		
	\$	%	\$	%	\$	%	\$	%	\$	%		
2 litre displayed retail price	2.99		3.69		3.69		4.06	100.00	3.98			
<u>Less</u> DSAP levy 11¢ per litre	0.22	7.36	0.22	5.96	0.22	5.96	0.22	5.42	0.22	5.53		
Net price after levy	2.77		3.47		3.47		3.84		3.76			
<u>Less</u> farm gate price 46.8¢ per litre ⁱ	0.94	31.30	0.94	25.37	0.94	25.37	0.94	23.05	0.94	23.52		
Net margin available to retailers & processors	1.83	61.34	2.53	68.67	2.53	68.67	2.90	71.53	2.82	70.95		
Total	2.99	100.00	3.69	100.00	3.69	100.00	4.06	100.00	3.98	100.00		

Notes: Locations for supermarkets used in liquid milk price comparisons: ^aWoolworths, Westfield Bondi Junction and Town Hall ^bIGA, Oxford Street, Darlinghurst ^cDuffy Bros, Oxford Street, Darlinghurst ^dColes Bondi Junction and City Express. **Brands:** ¹Woolworths private milk brands packaged by National Foods Limited ²National Foods Limited brands ³Coles private milk brands packaged by Australian Cooperative Foods Limited (Dairy Farmers) ⁴ Australian Cooperative Foods Limited Dairy Farmers brand ⁱBased upon farm gate prices quoted by Dairy Farmers Milk Cooperative (DFMC), March 2008.

Table 1.2 Snapshot of retail prices for 2 litre milk packs observed in inner Sydney on 18 April 2008 showing dairy processors' brands and supermarkets' private label brands compared to farm-gate prices for raw milk with permeate added

	Woolworths ^a				IGA ^b							
	Home Brand ¹	proportion	Milk ¹	proportion	Pura ²	proportion	Dairy Farmers ⁴	proportion	Pura ²	proportion	Dairy Fresh ²	proportion
	\$	%	\$	%	\$	%	\$	%	\$	%	\$	%
2 litre displayed retail price	2.19		2.59		2.99		3.69		3.99		2.79	
<u>Less</u> DSAP levy 11¢ per litre	0.22	10.05	0.22	8.49	0.22	7.36	0.22	5.96	0.22	5.51	0.22	7.89
Net price after levy	1.97		2.37		2.77		3.47		3.77		2.57	
<u>Less</u> assumed farm gate price of 43.82¢ per litre ³ discounted with 10% permeate added	0.88	40.02	0.88	33.84	0.88	29.31	0.88	23.75	0.88	21.96	0.88	31.41
Net margin available to retailers & processors	1.09	49.94	1.49	57.67	1.89	63.33	2.59	70.29	2.89	72.52	1.69	60.70
Total	2.19	100.00	2.59	100.00	2.99	100.00	3.69	100.00	3.99	100.00	2.79	100.00
	Duffy ^c				Coles ^d							
	Dairy Fresh ²	proportion	Pura ²	proportion	Dairy Farmers ⁴	proportion	Coles ³	proportion	Dairy Farmers ⁴	proportion		
	\$	%	\$	%	\$	%	\$	%	\$	%		
2 litre displayed retail price	2.99		3.69		3.69		4.06		3.98			
<u>Less</u> DSAP levy 11¢ per litre	0.22	7.36	0.22	5.96	0.22	5.96	0.22	5.42	0.22	5.53		
Net price after levy	2.77		3.47		3.47		3.84		3.76			
<u>Less</u> assumed farm gate price of 43.82¢ per litre ³ discounted with 10% permeate added	0.88	29.31	0.88	23.75	0.88	23.75	0.88	21.59	0.88	22.02		
Net margin available to retailers & processors	1.89	63.33	2.59	70.29	2.59	70.29	2.96	73.00	2.88	72.45		
Total	2.99	100.00	3.69	100.00	3.69	100.00	4.06	100.00	3.98	100.00		

Notes: Locations for supermarkets used in liquid milk price comparisons: ^aWoolworths, Westfield Bondi Junction and Town Hall ^bIGA, Oxford Street, Darlinghurst ^cDuffy Bros, Oxford Street, Darlinghurst ^dColes Bondi Junction and City Express.
Brands: ¹Woolworths private milk brands packaged by National Foods Limited ²National Foods Limited brands ³Coles private milk brands packaged by Australian Cooperative Foods Limited (Dairy Farmers) ⁴ Australian Cooperative Foods Limited Dairy Farmers brand ⁵Based upon farm gate prices quoted by Dairy Farmers Milk Cooperative (DFMC), March 2008.

Table 1.3 Snapshot of retail prices for 3 litre milk packs observed in inner Sydney on 18 April 2008 showing dairy processors' brands and supermarkets' private label brands compared to farm-gate prices for raw milk without permeate added

	Woolworths ^{a1}				IGA ^b				Coles ^d					
	Home Brand	proportion	Milk	proportion	Pura ²	proportion	Pura ²	proportion	Smart buy ³	proportion	Coles ³	proportion	Dairy Farmers ⁴	proportion
	\$	%	\$	%	\$	%	\$	%	\$	%	\$	%	\$	%
3 Litres displayed retail price	3.19		3.79		3.99		5.30		3.90		3.79		5.60	
<u>Less</u> DSAP levy 11¢ per litre	0.33	10.34	0.33	8.71	0.33	8.27	0.33	6.23	0.33	8.46	0.33	8.71	0.33	5.89
Net price after levy	2.86		3.46		3.66		4.97		3.57		3.46		5.27	
<u>Less</u> farm gate price 46.8¢ per litre ⁱ	1.40	44.01	1.40	37.04	1.40	35.19	1.40	26.49	1.40	36.00	1.40	37.04	1.40	25.07
Margin available to retailers & processors	1.46	45.64	2.06	54.25	2.26	56.54	3.57	67.28	2.17	55.54	2.06	54.25	3.87	69.04
Total	3.19	100.00	3.79	100.00	3.99	100.00	5.30	100.00	3.90	100.00	3.79	100.00	5.60	100.00

Notes: Location for supermarkets used in liquid milk price comparisons: ^aWoolworths, Westfield Bondi Junction and Town Hall ^bIGA, Oxford Street, Darlinghurst ^cDuffy Bros, Oxford Street, Darlinghurst ^dColes Bondi Junction and City Express.
Brands: ¹Woolworths private milk brands packaged by National Foods Limited ²National Foods Limited brands ³Coles private milk brands packaged by Australian Cooperative Foods Limited (Dairy Farmers) ⁴ Australian Cooperative Foods Limited, Dairy Farmers brand ⁱBased upon farm gate prices quoted by Dairy Farmers Milk Cooperative (DFMC), March 2008.

Table 1.4 Snapshot of retail prices for 3 litre milk packs observed in inner Sydney on 18 April 2008 showing dairy processors' brands and supermarkets' private label brands compared to farm-gate prices for raw milk with permeate added

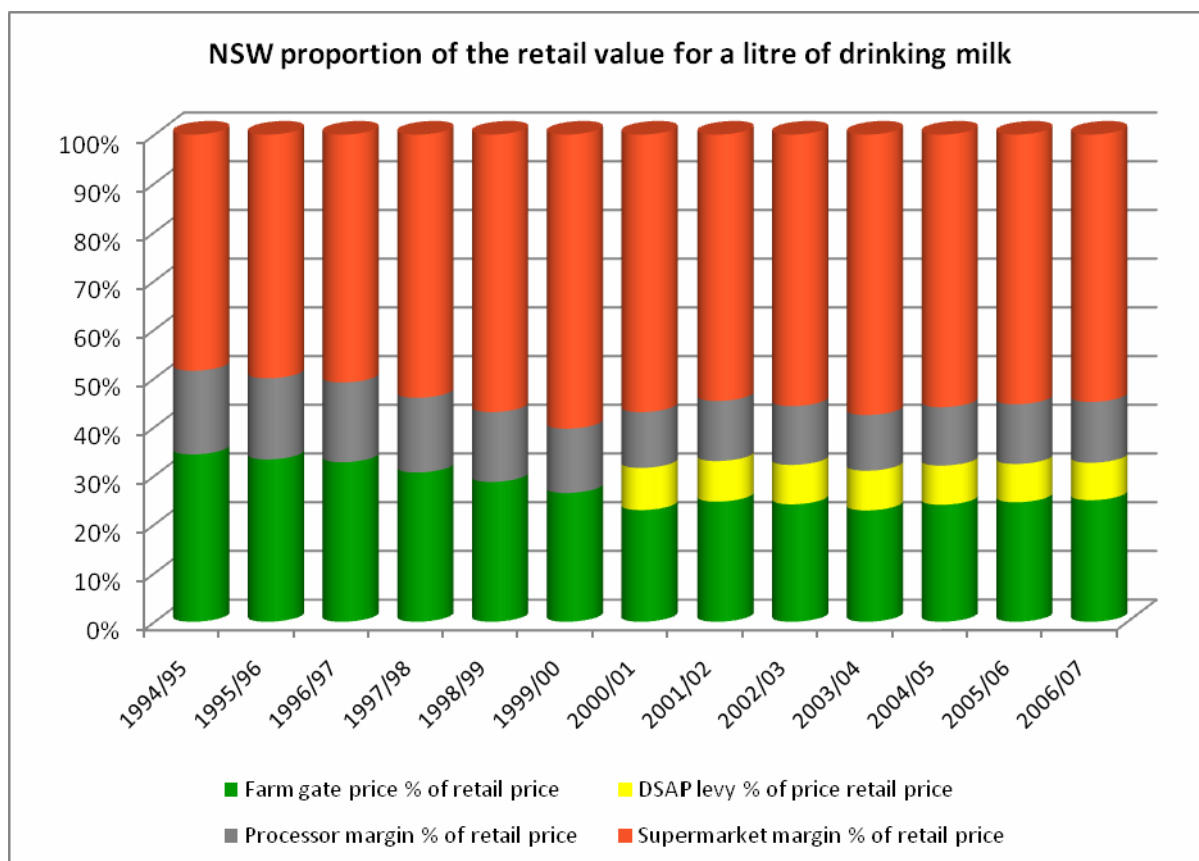
	Woolworths ^{a1}				IGA ^b				Coles ^d					
	Home Brand	proportion	Milk	proportion	Pura ²	proportion	Pura ²	proportion	Smart buy ³	proportion	Coles ³	proportion	Dairy Farmers ⁴	proportion
	\$	%	\$	%	\$	%	\$	%	\$	%	\$	%	\$	%
3 Litres displayed retail price	3.19		3.79		3.99		5.30		3.90		3.79		5.60	
<u>Less</u> DSAP levy 11¢ per litre	0.33	10.34	0.33	8.71	0.33	8.27	0.33	6.23	0.33	8.46	0.33	8.71	0.33	5.89
Net price after levy	2.86		3.46		3.66		4.97		3.57		3.46		5.27	
<u>Less</u> assumed farm gate price of 43.82¢ per litre ⁱ discounted with 10% permeate added	1.31	41.21	1.31	34.69	1.31	32.95	1.31	24.80	1.31	33.71	1.31	34.69	1.31	23.48
Margin available to retailers & processors	1.55	48.45	2.15	56.61	2.35	58.78	3.66	68.97	2.26	57.83	2.15	56.61	3.96	70.63
Total	3.19	100.00	3.79	100.00	3.99	100.00	5.30	100.00	3.90	100.00	3.79	100.00	5.60	100.00

Notes: Locations for supermarkets used in liquid milk price comparisons: ^aWoolworths, Westfield Bondi Junction and Town Hall ^bIGA, Oxford Street, Darlinghurst ^cDuffy Bros, Oxford Street, Darlinghurst ^dColes Bondi Junction and City Express.
Brands: ¹Woolworths private milk brands packaged by National Foods Limited ²National Foods Limited brands ³Coles private milk brands packaged by Australian Cooperative Foods Limited (Dairy Farmers) ⁴ Australian Cooperative Foods Limited, Dairy Farmers brand ⁱBased upon farm gate prices quoted by Dairy Farmers Milk Cooperative (DFMC), March 2008.

Changes in proportion of retailers' and farmers' share of consumer spending

In the 13 years since 1994 being the six years prior to and the seven years since deregulation the retailers' share of the consumers spend has increased from 48.5 percent to 54.9 percent, whereas processors' share has, based upon an approximate margin of 50 percent of the farm gate milk price, declined from 17.2 percent to 12.5 percent. Dairy farmers' share of the retail dollar has fared even less favourably reducing from 34.3 percent to 25.0 percent. These proportions are illustrated in Graph 2.

Significantly in 2000/01 the year of deregulation retailers increased their share of consumers' spend to 57.0 percent whereas dairy farmers, DSAP levy and processors' shares were 22.9, 8.7 and 11.5 percent respectively.



Graph 2 Illustrates changes in the proportion of the average retail price for liquid milk in NSW between, farmers, processor and retailers from 1994-5 to 2006-7

The extent of changes in both farm gate and retail prices in Queensland, NSW and Victoria over the 13 years is:⁶

State	Farm gate price		Change		Retail price		Change	
	1994/5	2006/7	¢	%	1994/5	2006/7	¢	%
Queensland	42.4	38.7	-3.7	-8.7	1.16	1.44	+0.28	+24.1
NSW	39.4	35.7	-3.7	-9.4	0.90	1.43	+0.53	+58.9
Victoria	25.6	32.0	+6.4	+25.0	1.24	1.54	+0.30	+24.2

In 1994-5 higher farm gate prices in Queensland and NSW reflect the extent of regulation and in terms of retail prices the extent of price control.

⁶ Data sources Dairy Australia, ABARE Commodity Price Bulletins, and some retail prices have been extrapolated by regressing price increases.

As will be illustrated elsewhere intervening years those dairy farmers remaining have responded to their changed trading environment by increasing production in order to reduce unit production costs. However, these productive benefits have largely been captured by the retail sector.

Although an argument could be mounted that the DSAP levy component of retail value either benefits or has benefitted dairy farmers. The point is that this was a past benefit paid in part as a compensation package for the industry restructure and the levy repays to the Australian Government funds advanced to meet the compensation and program payments. When the DSAP levy ceases in 2010 then this ought to be reflected in lower retail drinking milk prices.

Dairy Australia stated in its recent Situation and Outlook report⁷:

'...With the stability of the domestic market and healthy export markets available, manufacturers do have market and product options. The domestic market may be less attractive to some manufacturers given the margin pressure from retailers, and their reluctance to pass full price increases onto consumers.'

This then strongly suggests the market power exerted over processors by retail chains which may then depending upon contractual arrangements be passed back to the farm gate.

⁷ Dairy Australia (2008), Dairy 2008: Situation and Outlook Summary Report.

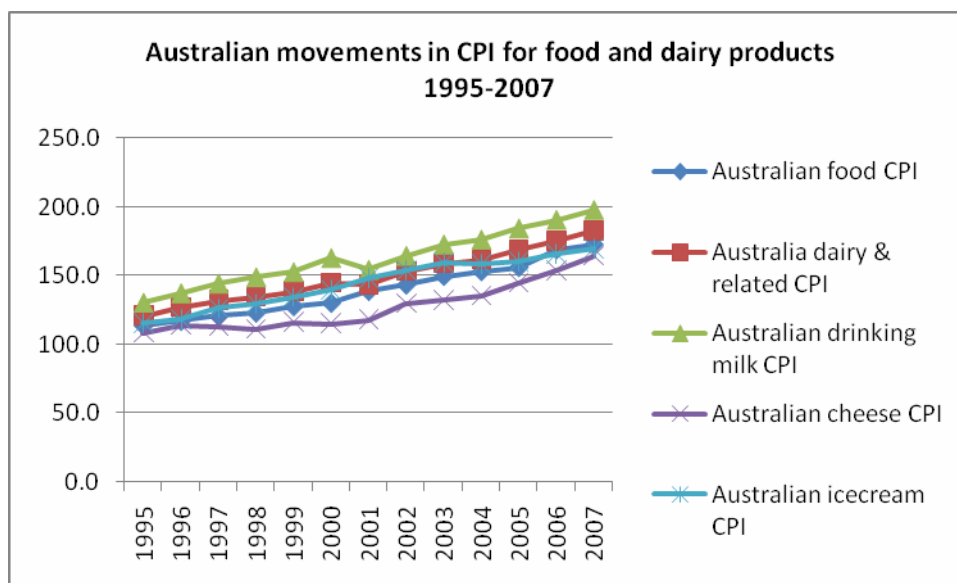
Table 2.1 The value chain proportions enjoyed by the relative proportions of average retail selling price for each major sector for drinking milk determined by reference to average farm gate and retail prices¹

	Retail price	Farm gate price	Farm gate price proportion of retail	DSAP levy	Percent of retail	Processor proportion of retail		Total for non-retail sector		Retail share	Retail proportion
	\$ per litre	¢ per litre	%	¢ per litre	%	¢ per litre	%	¢ per litre	%	¢ per litre	%
New South Wales											
2005/06	1.40	0.343	24.53	0.11	7.86	0.17	12.27	0.63	44.65	.77	55.35
2006/07	1.44	0.357	24.78	0.11	7.64	0.18	12.39	0.65	44.81	.79	55.19
Victoria											
2005/06	1.50	0.329	21.92	0.11	7.33	0.16	10.96	0.60	40.22	.90	59.78
2006/07	1.54	0.320	20.79	0.11	7.14	0.16	10.40	0.59	38.33	.95	61.67
Queensland											
2005/06	1.40	0.366	26.13	0.11	7.86	0.18	13.07	0.66	47.05	.74	52.95
2006/07	1.43	0.387	27.09	0.11	7.69	0.19	13.55	0.69	48.33	.74	51.67

¹Source: Dairy Australia, Dairy Processors and Supermarket sales data - ex-AC Nielsen's Scantrack

CPI and relationship to farm gate prices

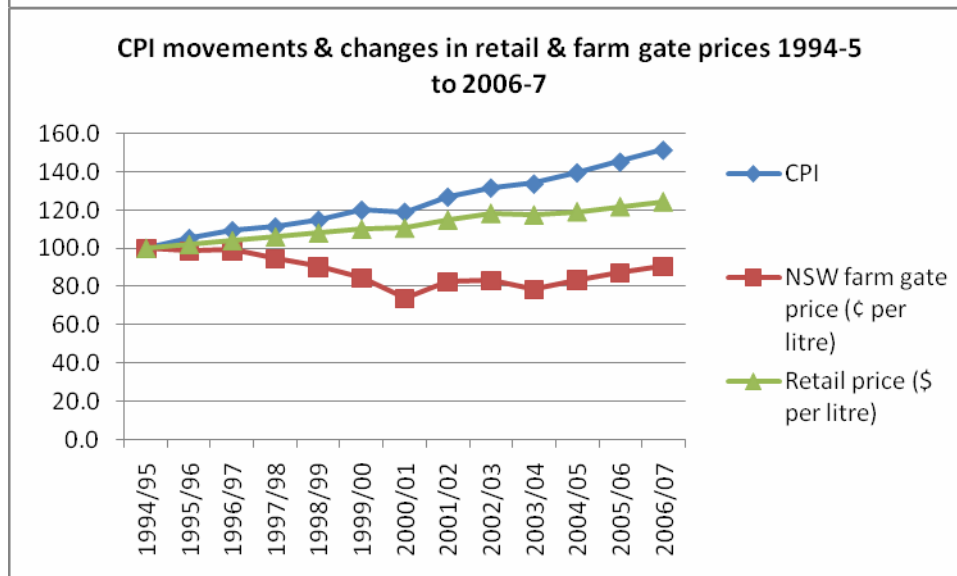
The following Graphs 3, 4 and 5 illustrate major food retailers' contribution to food CPI increases.



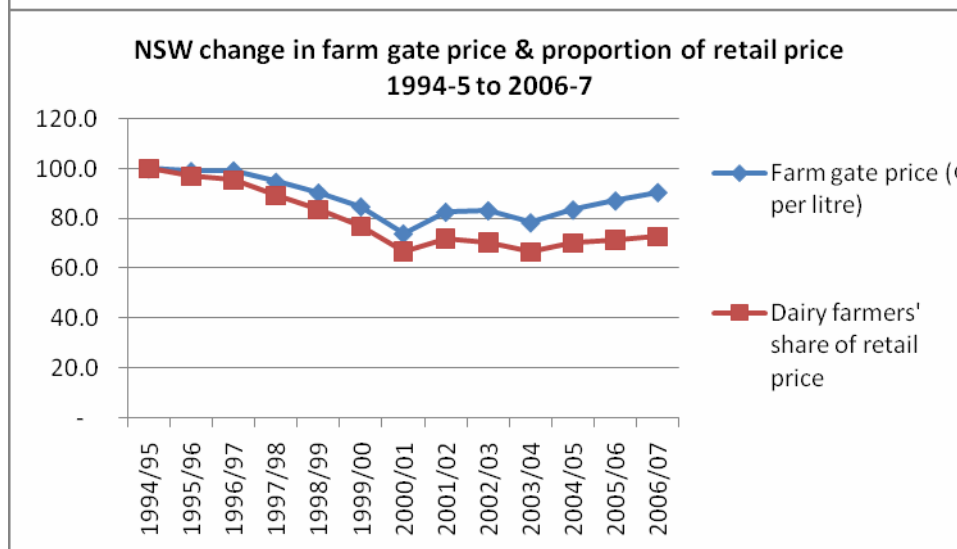
Graph 3 Illustrates the movements in CPI for the major dairy products in the 13 years from 1994-5 to 2006-7.

Clearly drinking milk has outstripped other dairy products in CPI increases, yet it is the one dairy product with the smallest loss and least processing to transform raw milk into a saleable retail product.

Conversely, cheese has shown a lower CPI increase when considering the labour and capital intensity in its differing processing techniques, styles, types and curing times. The suggest that factors influencing CPI are attributable to increased collection and distribution costs, higher wages in both processing and retailing sectors, packaging costs, but most significantly higher retail margins.



Graph 4 Demonstrates that clearly farm gate prices are not a factor in CPI. As in actual terms in NSW and Queensland farm gate prices have declined. However, in 2008 farm they have increased significantly.

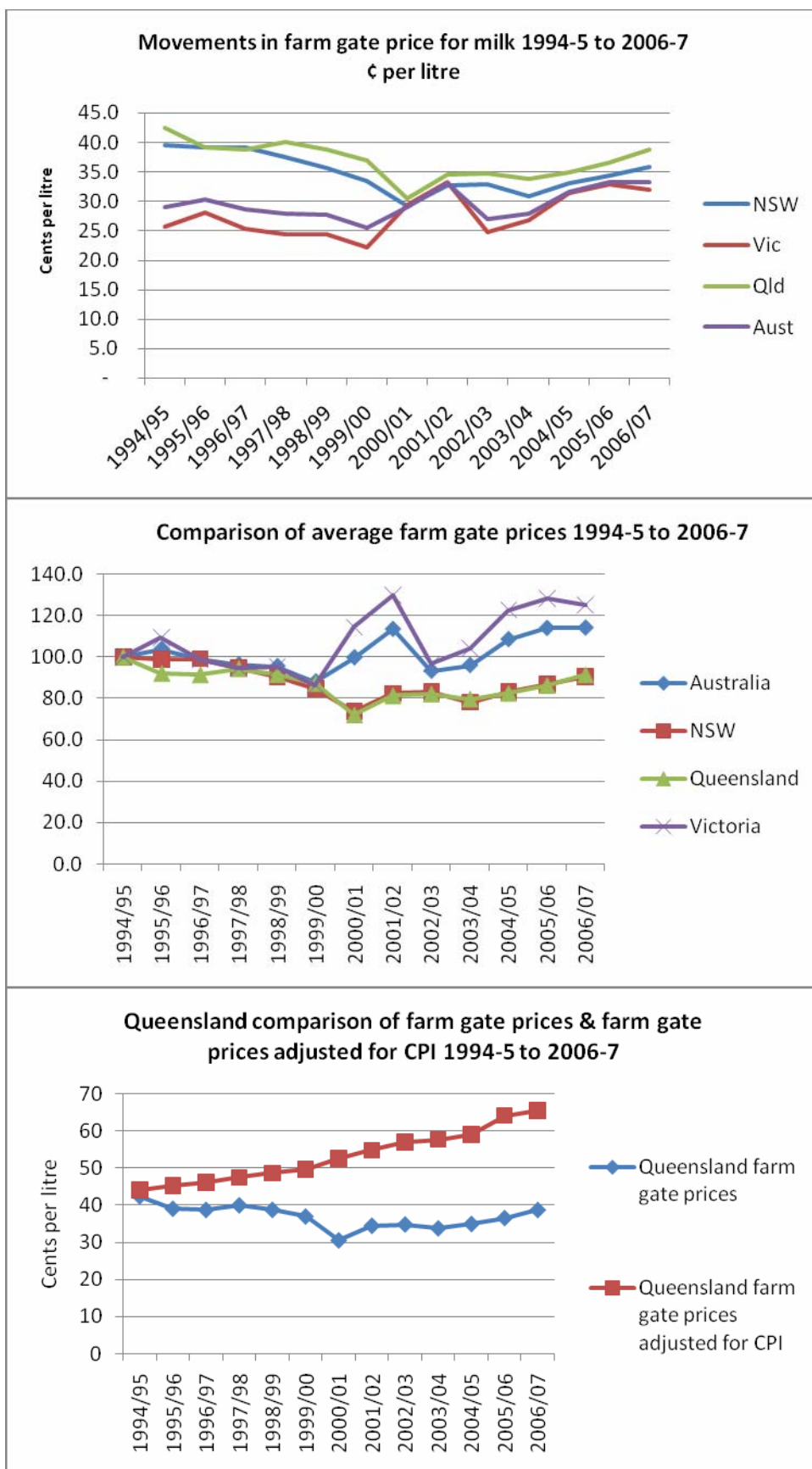


Graph 5 Illustrates that major retailers have captured a significantly higher proportion of retail expenditure at dairy farmers' expense.

Date sources: Dairy Australia & ABS

Average farm gate milk prices and CPI adjusted farm gate prices

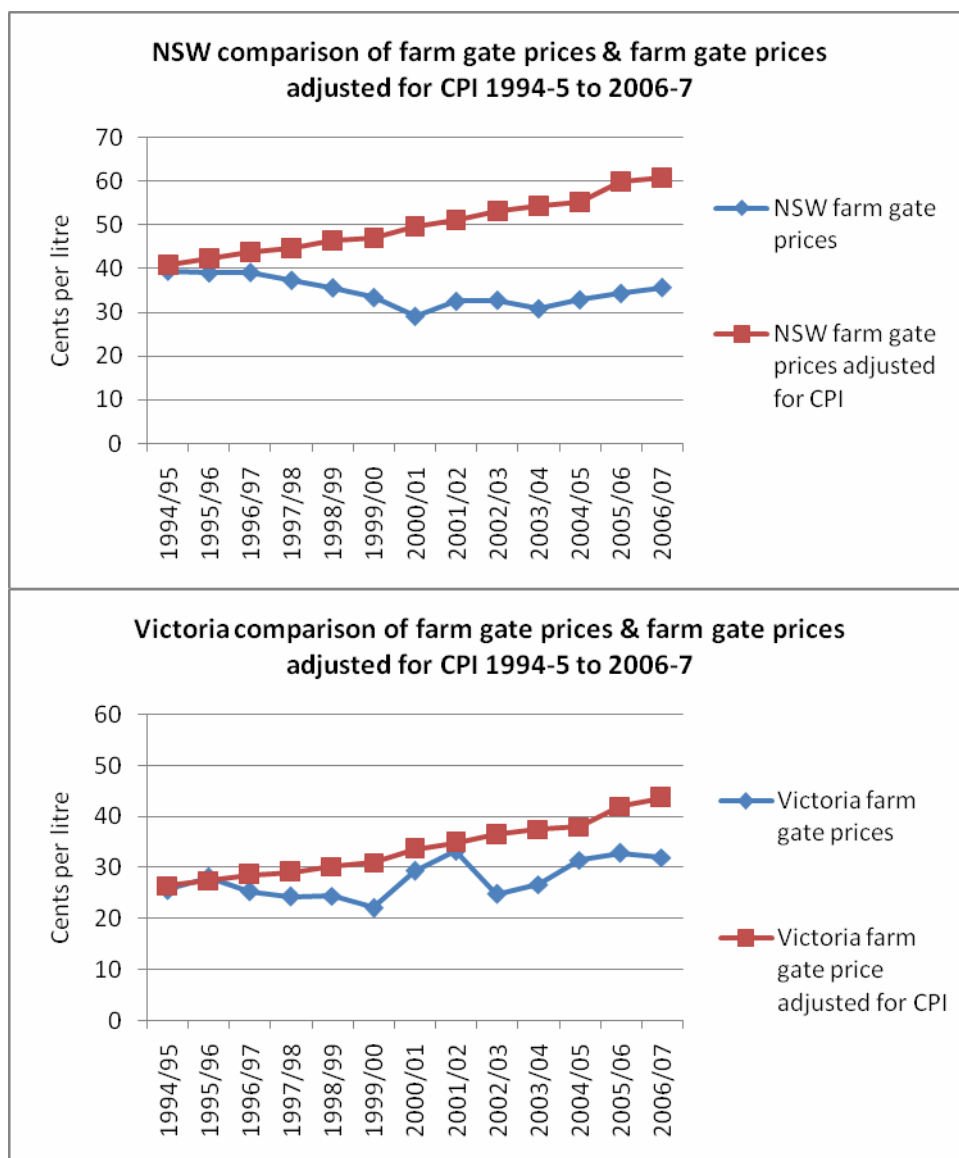
Graphs 6 and 7 compare average farm gate prices for Australia and the eastern states of Queensland, NSW and Victoria; the first as an index and the second in cents per litre. Graphs 8, 9 and 10 illustrate how farm gate prices would have moved had they kept pace with CPI movements.



Graph 6 Shows farm gate price movements expressed as ¢ per litre. It would appear that Queensland and NSW dairy farmers fare better than their counterparts in Victoria, South Australia and southern NSW. The volume of milk produced in southern Australia and the largely seasonal production allows for some greater cost control compared with dairy farmers in Queensland and central and northern NSW whose production focus is on year round production. The production incentive is 2.5¢ pr litre.

Graph 7 Expresses farm gate prices as an index and it thus more clearly illustrates the trends in farm gate prices and the greater vulnerability of dairy farmers to the exercise of market power who supply either the Sydney or south east Queensland and northern NSW markets. We contend that the greater competition in Victoria, South Australia and southern NSW at the farm gate with more processors has allowed them to benefit from it and as a result prosper.

Graphs 8, 9 & 10 Demonstrate the loss of relativity of farm gate prices when adjusted



for movements in CPI, in Queensland this gap is 26.9¢ per litre, NSW 25.1¢ per litre compared to Victoria where the gap is 11.6¢ per litre. Farmers in Queensland at June 2007 were receiving farm gate prices 3.7¢ lower than in 1994-5, NSW 4.7¢ per litre lower whereas Victorian dairy farmers are 6.4¢ per litre better off over the same period.

The lack of competition at the farm gate and the relatively stronger bargaining power of major supermarkets chains then the lower the returns will be derived from dairying and then too the greater will be the structural problems that we canvass elsewhere.

Date sources: Dairy Australia & ABS

The stronger correlation of farm gate prices in Victoria to CPI movements reflects their dairy farmers' stronger bargaining power and greater competition at the farm gate for milk. The sharp movements 2002-4 reflect low international prices for dairy products; the flattening of prices in the period 2004-7 reflects the improved international markets but also strengthening Australian dollar and hence more subdued export market returns.

Changes in dairy farm production

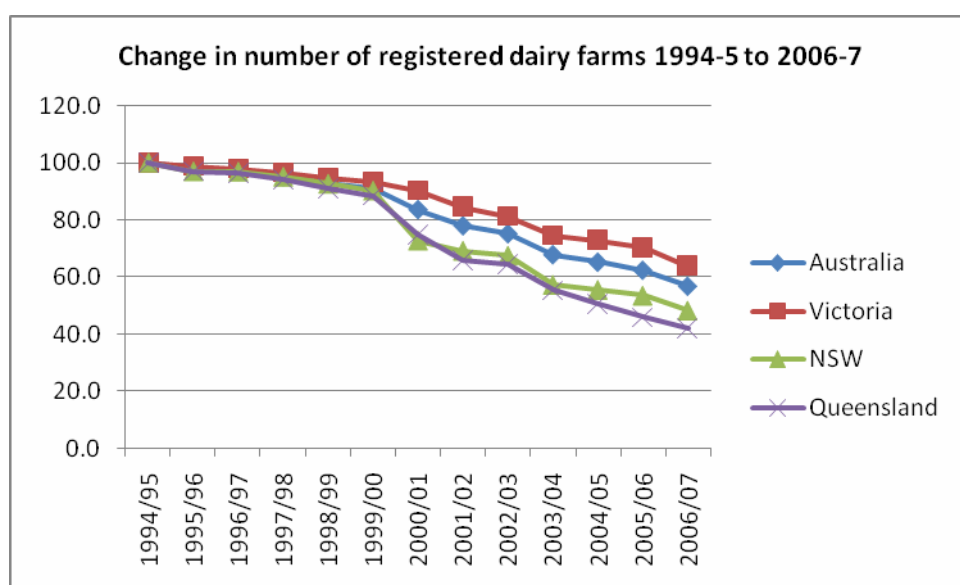
Number of registered dairy farms

Since the period of a deregulated trading environment commenced eight years ago the dairy industry has undergone a rapid period of structural adjustment, not all of the consequences were predicted. Dairy farmers in states like Queensland and NSW had operated in a highly regulated trading environment, where both farm gate prices and retail prices were fixed, even to the point of distribution. Dairying had long been an instrument of closer settlement which was seen by governments as a desirable social objective and a means of land redistribution and more especially as an adjunct of the post World War I Soldier Settlement Scheme and also the post World War II War Service Land Settlement Scheme. The industry was heavily supported through market support programs and in states like Queensland and NSW their various Milk Acts, dating from the 1930s until the 1990s expropriated the property right in milk to the state through their marketing and regulating authorities.

This environment tended to encourage farmers to argue for a farm gate price increase on the basis of an increase in input costs which was more often than not granted. This was then quickly passed onto retail prices and consequently this increased the value of quotas; so the industry became very adept at rent seeking.

Deregulation returned to dairy farmers the absolute property right in their milk; they were compensated for the loss of their quotas and also to prepare to adjust to the new trading environment. Equally domestic oriented processors were at sea in adjusting to this new trading environment and to a large measure were unused to a truly competitive trading environment. This we contend has had two consequences being to develop a secondary milk market between processors to deal with specific regional shortfalls and in turn this has led onto exclusive trading arrangements with the major supermarket chains as they rapidly filled the vacuum the new conditions created.

A variety of equally valid reasons can be offered as to why there has been a sharp decline in the number of dairy farms across Australia; these are as varied as disillusionment with the lifestyle, declining terms of trade, lack of critical mass, urban encroachment and to more recently drought-caused irrigation water shortages.



Graph 11 Shows an accelerating rate of decline in the number of registered dairy farms in the eastern mainland states.

Queensland and NSW have the highest exiting rates with number of dairy farms declining by 58 and 51.6 percent respectively.

Data source: Dairy Australia

In the period prior to and in the immediate run-up to deregulation a reason that could be advanced was that many dairy farmers were awaiting an accommodating exiting and/or readjustment compensation package. The exiting rate in 2000-01 in Queensland was 13.7 percent and in NSW 17.5 percent. This to some extent helps to explain the immediate post-deregulation exiting rates, but it does not explain the continuing and accelerating exiting rates seen over the past five or six years. The average exiting rate in Queensland has averaged 6.6 percent and in NSW 6.0 percent, whereas the average for Australia is 4.9 percent and for Victoria 4.2 percent.

Exiting rates in Victoria are at two-thirds those of NSW and Queensland. The majority of the Victorian, South Australian and south western NSW industry is heavily oriented towards export markets and is largely based upon seasonal production and much of it relies upon extensive irrigation. Water or its lack is the major impediment to an increased production response in this region. Others factors are, of course, greatly increased grain and hay costs, if available, as well as fuel and fertiliser costs much of this is, in turn, either imported or a by product of petrochemical production.

Whereas the central and northern NSW and south-eastern Queensland industry is more coastal based and is focused towards the domestic market. This we contend is largely attributable to past narrow sighted pricing policies forced in part upon processors by supermarket chains use of their market bargaining power and backed up by the notion of plentiful milk supplies even if located some

distance away. Today the penalty for this is yet to be inflicted upon consumers in the form of higher prices with a significant justification being attributable to increased freight costs.

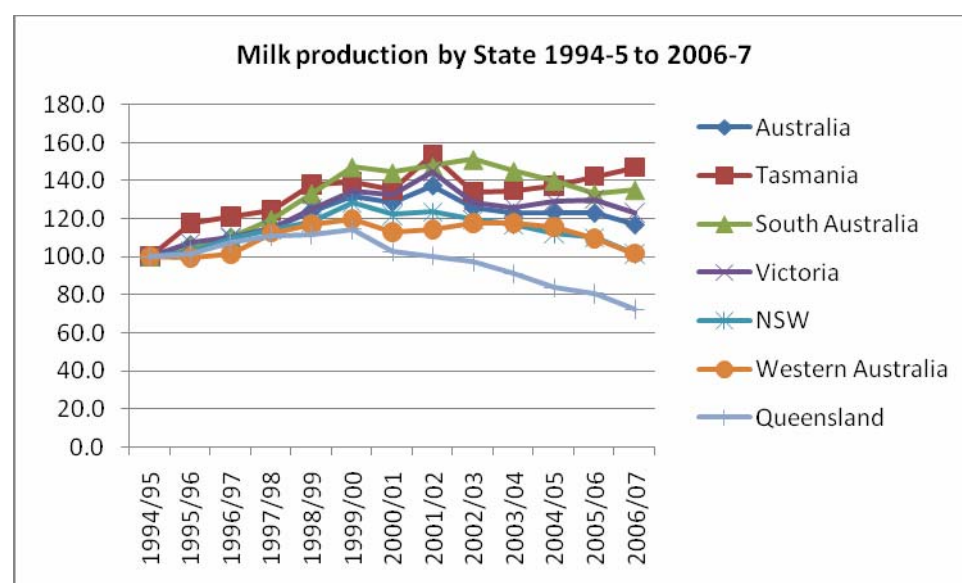
The two major factors contributing factor to high exiting rates are drought and poor farm gate prices. The following illustrates the changes in the number of registered dairy farms in the three eastern states and for Australia.

Change in the number of registered dairy farms⁸

	1994-5	1999-00	Change up to deregulation		2006/7	Change since deregulation	
	No thousand	No thousand	No thousand	%	No thousand	No thousand	%
Australia	14,166	12,896	-1,270	-9.0	8,055	-4,481	-37.5
Victoria	8,379	7,806	-573	-6.8	5,346	-2,406	-31.5
NSW	1,911	1,725	-186	-9.7	924	-2,460	-46.4
Queensland	1,746	1,545	-201	-11.5	734	-811	-52.5

On Farm production

The following series of graphs demonstrate changes in the volume of milk produced, nationally and by state, per farm and per cow the number of cows by state and by farm. Those dairy farms remaining have substantially increased milk production. This has been gained through two factors, namely more cows per farm and greater volumes of milk produced per cow.



Graph 12 Illustrates changes in national milk production profile. Queensland production has declined sharply, 27.9 with smaller but significant declines in NSW and WA.

Whilst there has been a decline in some other states these have been more related to drought and water shortages than to market dynamics.

Data source: Dairy Australia

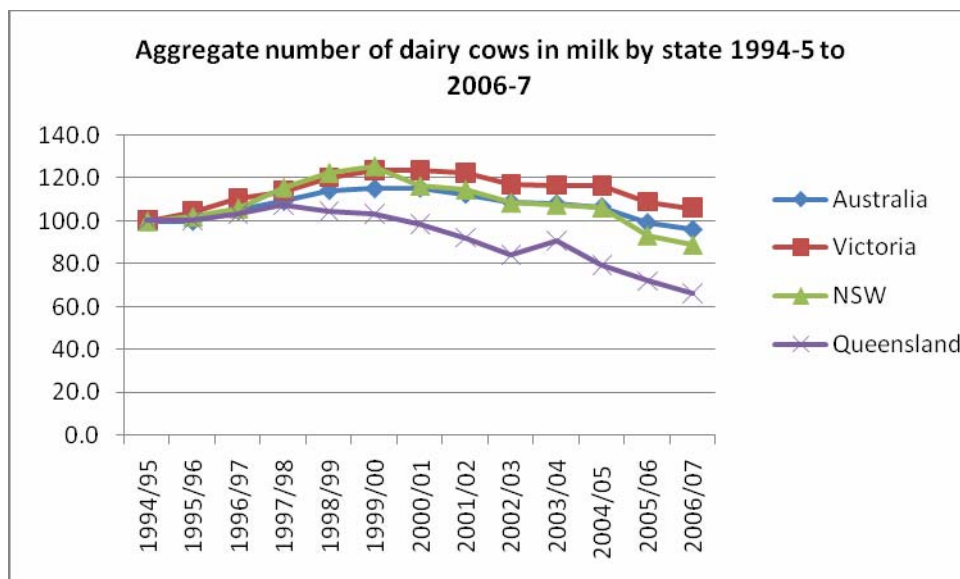
Number of cows in milk in each State⁹

	1994-5	1999-00	Change to deregulation		2006/7	Change since deregulation	
	No thousand	No thousand	No thousand	%	No thousand	No thousand	%
Australia	1,882	2,171	+289	+3.1	1,810	-361	-2.7
Victoria	1,113	1,377	+264	+4.5	1,180	-197	-2.4
NSW	230	289	+59	+5.0	205	-84	-5.1
Queensland	189	195	+6	+0.6	125	-70	-5.3

⁸ Data source: Dairy Australia

⁹ Data source: Dairy Australia

As has been pointed out Queensland and northern NSW generally have lower per cow production and hence higher input costs per litre of milk produced. Detailed figures can be obtained the Queensland Dairy Accounting Scheme (QDAS)¹⁰

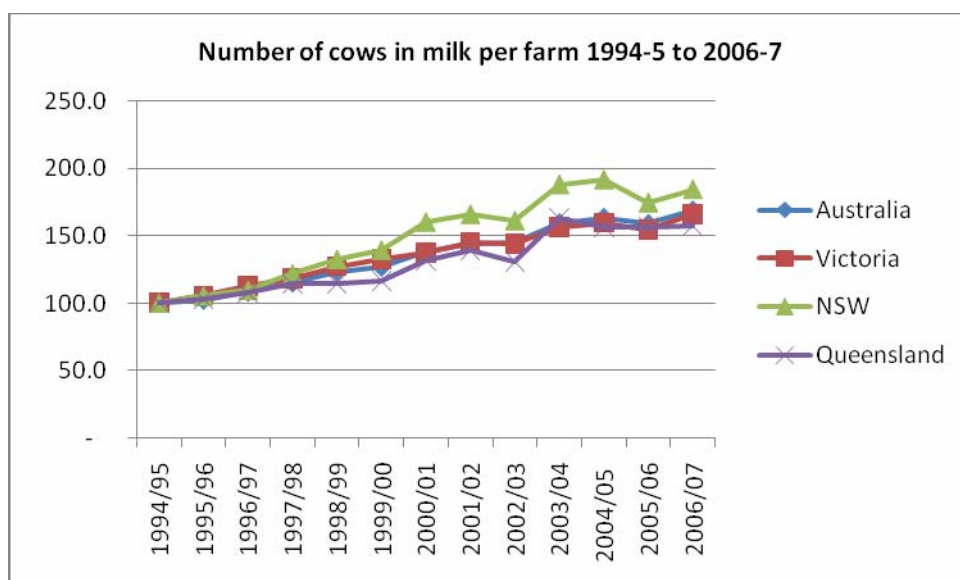


Graph 13 Shows the sharp decline in the number of cows in milk per state since deregulation. Whereas in the six years prior to deregulation there had been a substantial build up in cow number. The decline since deregulation could be related to both drought and in some states farm gate prices.

Cows in milk per farm

In the aftermath of deregulation remaining farms have had to work hard to increase their critical mass this has been achieved by:

- ◆ To get unit costs down, and
- ◆ Thereby increase business revenue.



Graph 14 Shows the change in the number of cows per farm. The highest increase has been in NSW with 102 cows or 84.3 percent per farm since 1994-5; increase in Queensland has been 62 cows or 57.3 percent; since deregulation the change has been 54 cows, 32.4 percent and 44 cows or 34.9 percent respectively.

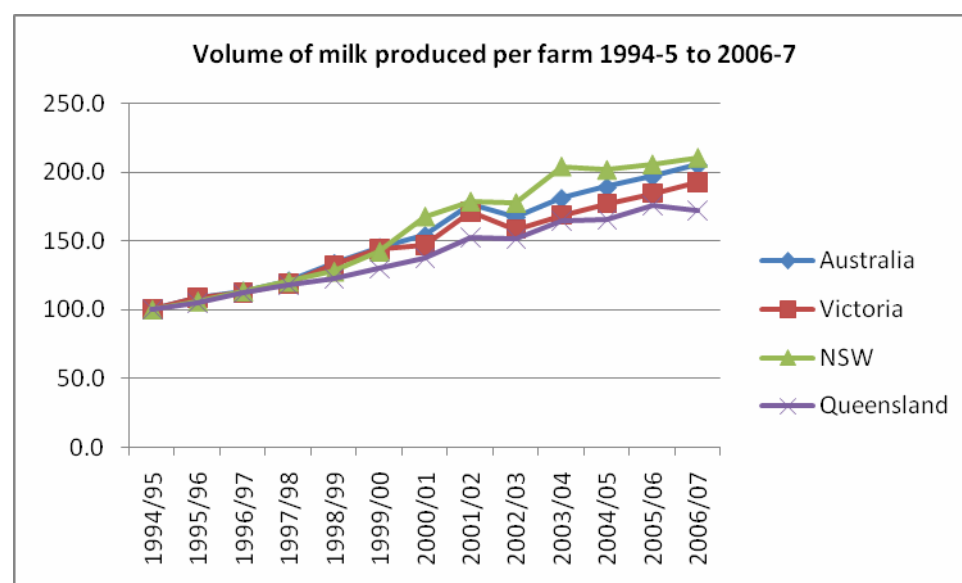
When considering changes in NSW consideration needs to be had for the market segment being supplied, be it in the southern NSW which is largely export oriented, the central part of the state is focused towards the NSW domestic market or northern NSW supplying the south east Queensland or the NSW north coast market.

¹⁰ Queensland Dairy Accounting Scheme (QDAS) <http://www.dairyinfo.biz/index.cfm?MenuID=81> access date 22 June 2008

	Number of cows in milk per farm ¹¹						
	1994-5	1999-00	Change to deregulation		2006/7	Change since deregulation	
	No hundred	No hundred	No hundred	%	No hundred	No hundred	%
Australia	133	168	+35	+26.7	225	+57	+42.4
Victoria	133	176	+43	+32.8	221	+45	+33.4
NSW	120	168	+48	+39.2	222	+54	+45.1
Queensland	108	126	+18	+16.6	170	+44	+40.7

Milk produced per farm

Whilst there has been a considerable reduction in the number of dairy farms there has not been a commensurate drop in the number of cows in milk, nor in the volume of milk produced.



Graph 15 Shows the average annual increase in on-farm milk production in the seven years since deregulation.

Overall Australian on-farm production has increased by 60.2 percent and in Queensland, NSW and Victoria by 42.2, 68.0 and 48.8 percent respectively.

Data source: Dairy Australia

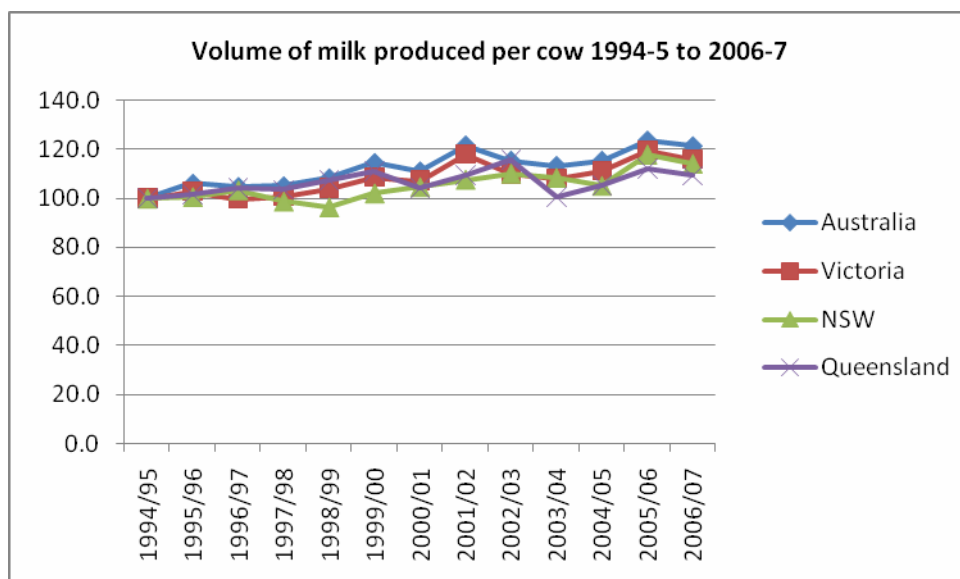
	Volume of milk produced per farm ¹²						
	1994-5	2000-1	Change up to deregulation		2006/7	Change since deregulation	
	Million litres	Million litres	Million litres	%	Million litres	Million litres	%
Australia	.579	.841	+.262	+45.2	1,190	+.349	+60.2
Victoria	.610	.880	+.270	+44.2	1,178	+.298	+48.8
NSW	.569	.808	+.239	+42.1	1,196	+.388	+68.0
Queensland	.424	.549	+.125	+29.5	.728	+.179	+42.2

Milk produced per cow

Increased milk production per cow is a combination of genetic improvement and nutrition, Graph 16 shows the change in per cow production. In tropical and subtropical climates can generally expect a lower genetic response. This also shows that cows cannot be easily taken from one climate and production system to another and maintain production. Daughters of a widely used bull in Victoria may not display a similar production response in Queensland given equally efficient management and access to similar nutrition. This is discussed in more detail in the next section.

¹¹ Data source: Dairy Australia

¹² Data source: Dairy Australia



Graph 16 Shows the improvement in milk production per cow in Queensland, NSW and Victoria compared to the national average. Most of this production increase comes from both genetic improvement and better nutrition. Each is linked as adequate nutrition allows for genetic expression (GE).

	Average volume of milk produced per cow ¹³				Change since deregulation		
	1994-5	2000-1	Change up to 2006/7				
	<i>Thousand litres</i>	<i>Thousand litres</i>	<i>Hundred litres</i>	<i>%</i>	<i>Thousand litres</i>	<i>Hundred litres</i>	<i>%</i>
Australia	4,360.1	4,996.3	+636.1	+14.6	5,294.3	+298.0	+6.8
Victoria	4,594.4	4,988.8	+394.4	+8.6	5,336.4	+347.6	+7.6
NSW	4,728.1	4,826.4	+98.2	+2.1	5,390.0	+563.6	+11.9
Queensland	3,916.5	4,350.8	+434.3	+11.1	4,275.3	-75.5	-1.9

Production response

Dairy cows are quite amazing natural barometers; most dairying occurs in temperate climates as for the most part high yielding dairy breeds originate in these climates. They are responsive to high or low diurnal temperatures, prolonged dry or wet weather, equally to good or bad nutrition on they do to herd and individual health. Drought across the eastern states has had a major impact upon production.

Dairying is a capital intensive industry in terms of land values, cow values and specialised infrastructure. The main factors influencing production response is any one or a combination of these four factors, being:

◆ Management

The more cows the more labour is needed, as a rule of thumb depending upon the number of cows in milk for each 80-100 cows one unit of labour is required this may vary depending upon milking frequency being either twice or sometimes three times per day. A farm's management is strongly influenced by the proprietor's capacity and capital to incorporate innovation into the production paradigm.

◆ More cows

These either have to be bred or purchased with the object of either buying or breeding cows that produce at or greater than the herd average that is after cows culled from the herd have been replaced. This is called Selection Intensity (SI) and includes the age profile of the herd and the number of cows moving into peak production cycles.

¹³ Data source: Dairy Australia

More often than not to make a significant expansion to a milking herd requires additional land, which either has to be purchased or leased along with investment in appropriate infrastructure to support the operation.

◆ Improved nutrition

Nutrition must be provided on a constant basis, through either high quality grazing or supplementary feeding or a combination of both; more often the latter. Nutrition is required for both maintenance of the cow and for production. Extra feed does not automatically result in extra production this is constrained by the cow's genetic potential to produce in optimal conditions given the climatic and weather conditions.

It is more difficult to obtain production response in tropical and sub tropical areas, which explains, in part, lower production in Queensland or northern NSW.

◆ Genetic improvement

This is obtained by the use of superior sires and dams in the herd. This is either through natural breeding, artificial insemination (called AI) or embryo transfer (called ET). Increasingly ET is used as it enables breeders in different parts of the world to efficiently access superior genetic material or to increase breeding potential in their own herds from superior cows using superior sires.

ET whilst highly effective is costly and in periods of financial stringency is one of the first programs to be curtailed. An average cost to obtain a live heifer calf (with ET *bull:heifer* ratio tends to be about 55:45) varies from a low of \$2,500 to a high of \$6,000 with an average of \$4,250. Thus 25 ET calves would cost in the vicinity of \$100,000 per cohort before they have produced a drop of milk.

Genetic response takes four years (called Generation Interval, GI); that is today's production derived from genetic improvement was planned and implemented four years ago.

Retail dairy product volumes and values

In the 13 years from 1994-5 to 2006-7 and more particularly since the dairy industry was deregulated in 2000 an ever growing proportion of dairy derived products are now being sold through large supermarkets chains, in terms of both volume and value captured. Whilst this phenomenon on the one hand seemingly provides consumers with convenience on the other with fewer competitors it lends itself to their exploitation. Some of this through exclusive supply arrangements linked to the production of private store brands.

This lack of competition is manifest in the dairy processing sector inasmuch as an opposing processor who does not have a contract to supply store brands to a supermarket chain has little or no opportunity to offer consumers choice of their products. For the most part those processors with a low export focus but a high value domestic fresh to market production are the most vulnerable.

Growth in supermarket sales can for example be seen through the fresh milk sales as it is this product that requires the least amount of processing to be turned into a saleable product and is easiest for consumers to visualise. In each of the three eastern states this growth in terms of volume and value is:

	Drinking milk (fresh and UHT) volume through supermarkets ¹⁴				
	2000-01 volume <i>million litres</i>	2006-07 volume <i>million litres</i>	Change ± volume <i>million litres</i>	% ±	Average annual growth %
Queensland	206,002	273,280	67,278	32.7	4.7
NSW	298,295	356,654	58,359	19.6	2.8
Victoria	264,872	310,438	45,566	17.2	2.5

¹⁴ Data source: Dairy Australia, AC Nielsen Scantrack

This growth is greater than the increase in the average Australian population growth of 1.3 percent.

Drinking milk (fresh and UHT) sales through supermarkets¹⁵

	2000-01 value million \$	2006-07 value million \$	Change \pm value million \$	% \pm	Average annual growth %
Queensland	262,227	394,106	131,879	50.3	7.2
NSW	379,366	509,750	130,384	34.4	4.9
Victoria	364,817	477,777	112,960	31.0	4.4

The aggregate value of dairy products sold through supermarkets in 2006-7 in the three eastern states amounted to \$3,254,821,000 comprising:

Aggregate of dairy product sales through supermarkets from 1994-5 to 2006-7¹⁶

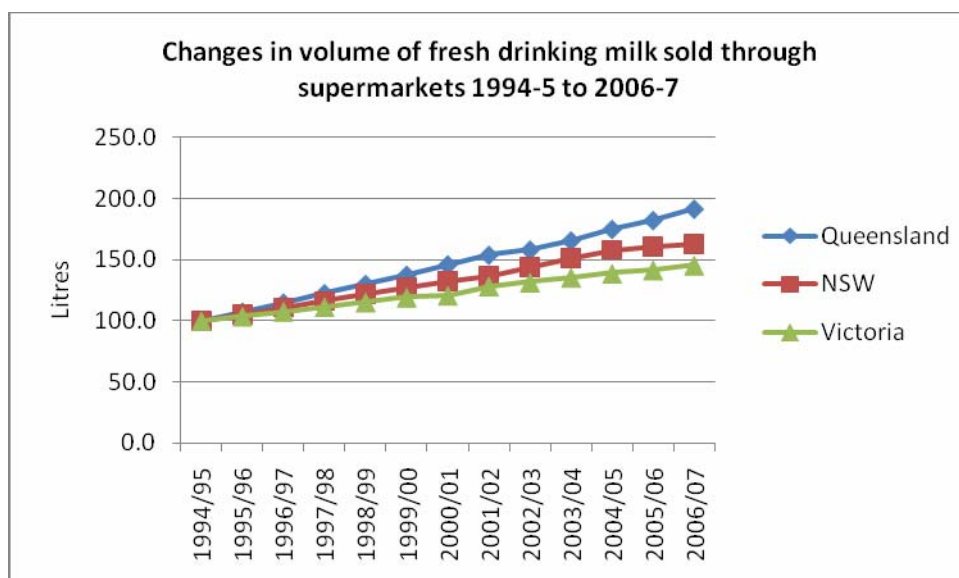
	2006-07 \$million	Growth %	Average annual growth %
Queensland	939,845	58.6	8.4
NSW	1,230,143	41.0	5.9
Victoria	1,084,833	39.3	5.6

Graphs 17 to 26 illustrate growth in supermarket sales in terms of both volume and value for fresh drinking milk, UHT milk, yoghurt, cheese (cheddar and other cheeses) and dairy spreads (butter and dairy blends).

Household spending comparisons used are based upon the average annual earnings for Australia of \$57,387¹⁷ average net after tax income is \$44,821 or \$861.94 per week, although these figures may vary from state to state.

Weekly expenditure on dairy products purchased through supermarkets can range from between two and five percent of net income. The largest component of this expenditure is on fresh drinking milk and obviously this varies depending upon the number of people in and the age composition of a household.

Fresh drinking milk



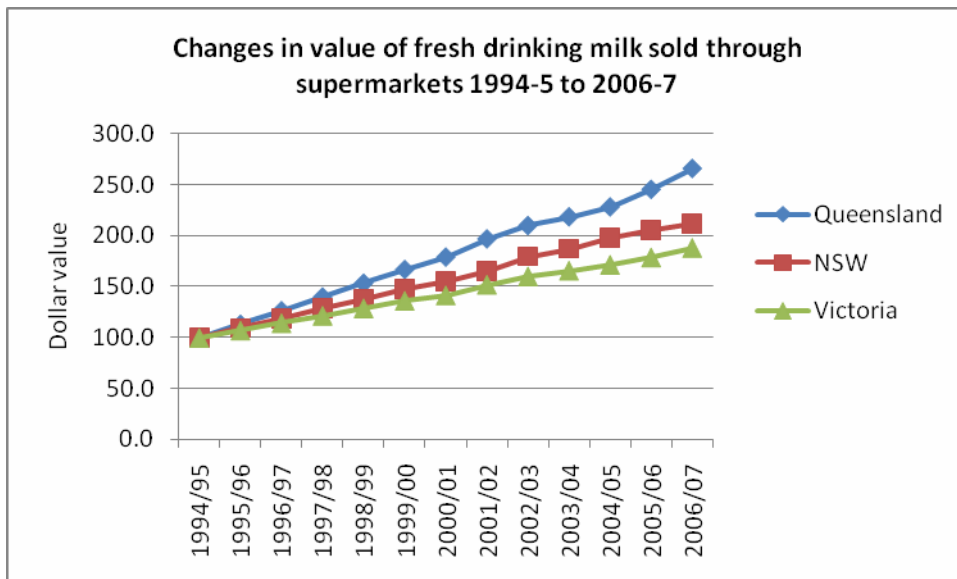
Graph 17 Annual per capita fresh drinking milk purchases through supermarkets is Queensland 59.6, NSW 45.6 and Victoria 51.7 being approximately a litre per week. For a family of four this equates to nearly 4.5 litres per week. This growth is not gained through increased consumption but from increased market share.

Data source: Dairy Australia

¹⁵ Data source: Dairy Australia, AC Nielsen Scantrack

¹⁶ Data source: Dairy Australia, AC Nielsen Scantrack

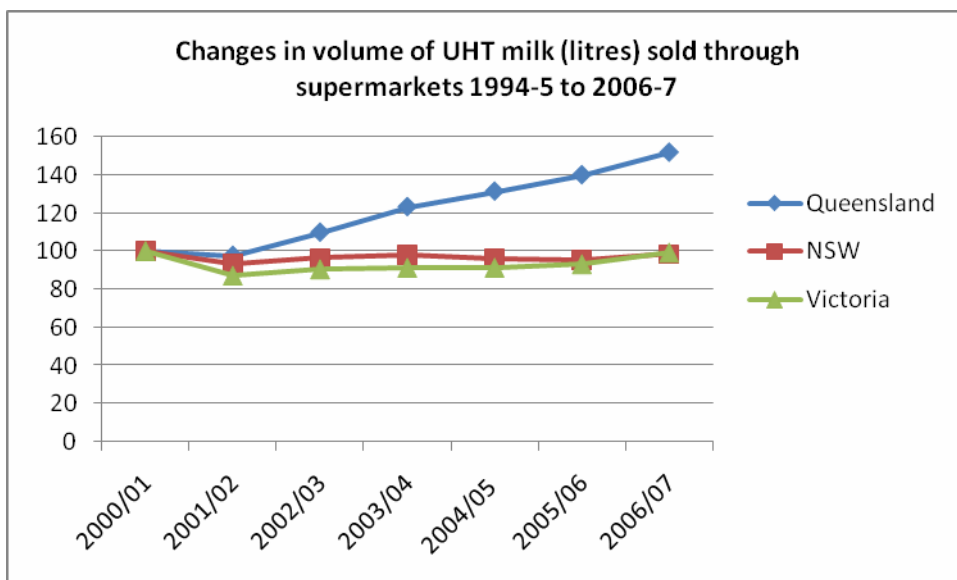
¹⁷ Australian Bureau of Statistics, 2007, <http://australia.emigratenz.org/salaries-australia.html> access date: 28 June 2008



Graph 18 Shows the steady annual growth in supermarket sales with such an accelerated growth rate the assumption can be made that some of this could only be through predatory pricing and the exercise of market power. Importantly this could reflect the lack of true competition and processors' specific supply agreements.

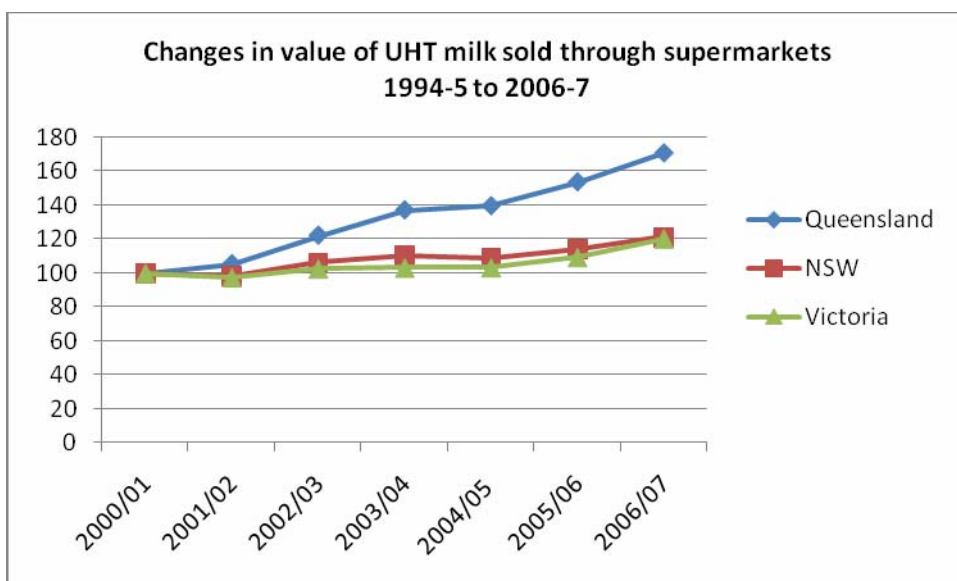
Data source: Dairy Australia

UHT milk

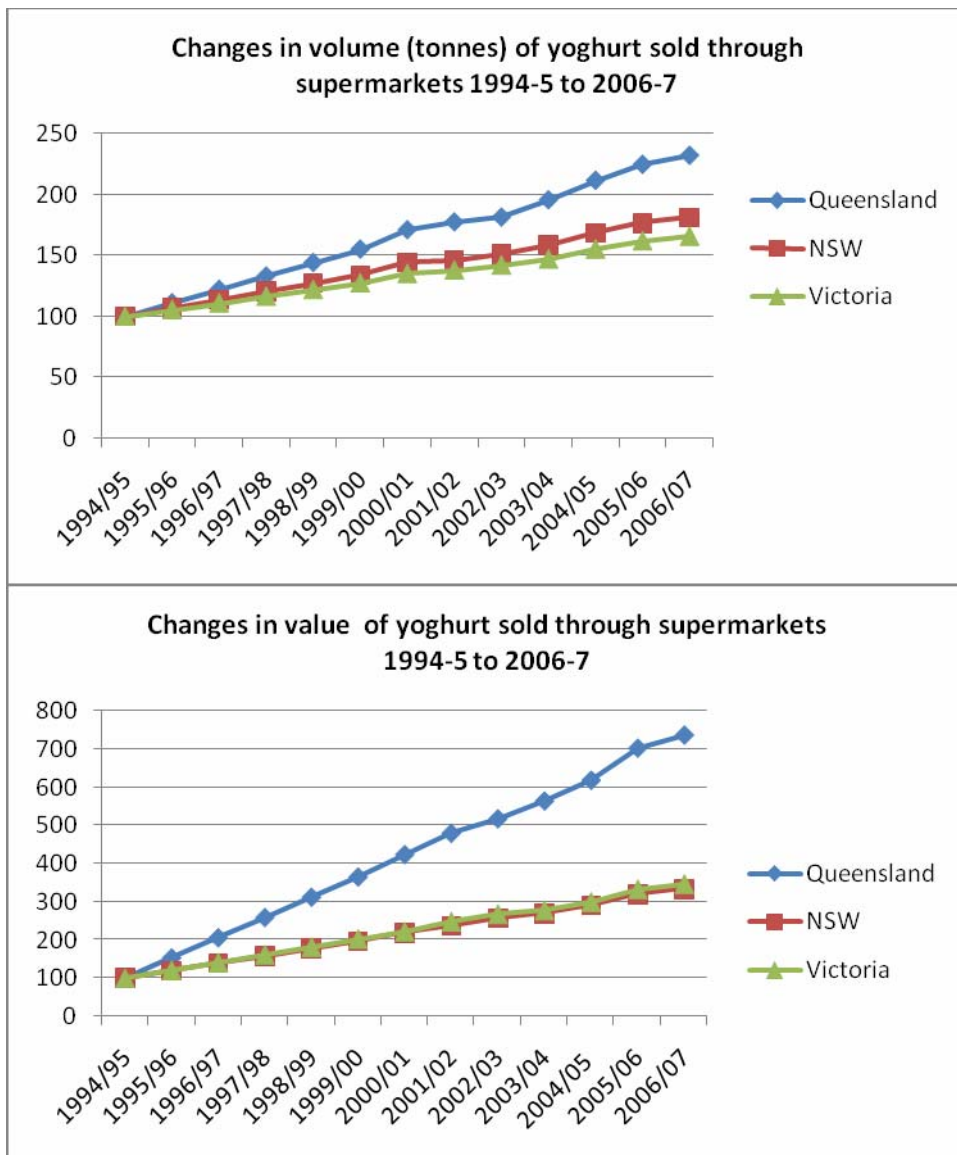


Graphs 19 & 20 Show changes in the volume and value of UHT milk sold through supermarkets. The market in Queensland has grown by 51.8 percent since deregulation an average of 7.4 percent per year. The growth in value reflects growth in consumption rather than merely higher prices, which have increased by 19¢ per litre over seven years or 12.8 percent. Growth in NSW and Victoria has been static. The increase in Queensland could be explained by climate, convenience, seasonal shortages and freight as probably little local milk is available for in this market, as well as predatory pricing although it is more highly priced than fresh milk. Flavoured UHT milks compete with other soft drink beverages.

Data source: Dairy Australia



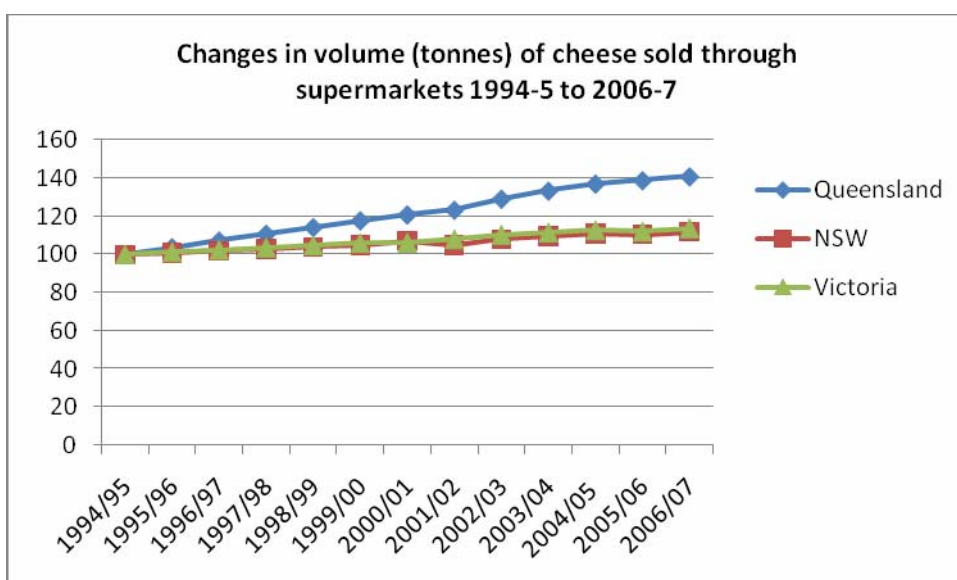
Yoghurt



Graphs 21 & 22 Yoghurt along with fresh drinking milk and cream are short shelf-life dairy foods. Yoghurt is marketed as a beneficial and healthy product. In its recent review Dairy Australia predicted yoghurts would be an area where major supermarket chains will seek to dominate the market with their house brands. Product supplies are linked to the processing arrangements between a chains major supplier, thus true competition between brands and processors is limited. Production is largely limited to domestically focused processors. Yoghurt, cheese and dairy spreads lend themselves to strong import competition from New Zealand through our free trade agreement (CER).

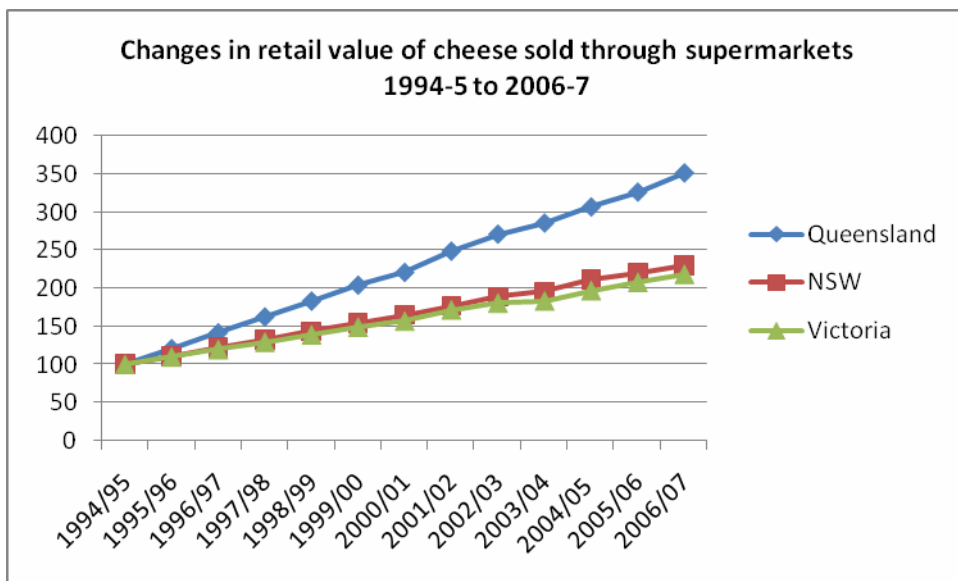
Data source: Dairy Australia

Cheese



Graph 23 Illustrates movements in the volume and value of cheese. Cheese is both a convenience and a gourmet product. At the speciality end of the market supermarkets have less bargaining power as they often also have to compete with export demand. Queensland shows higher growth than either NSW or Victoria, probably due to market concentration.

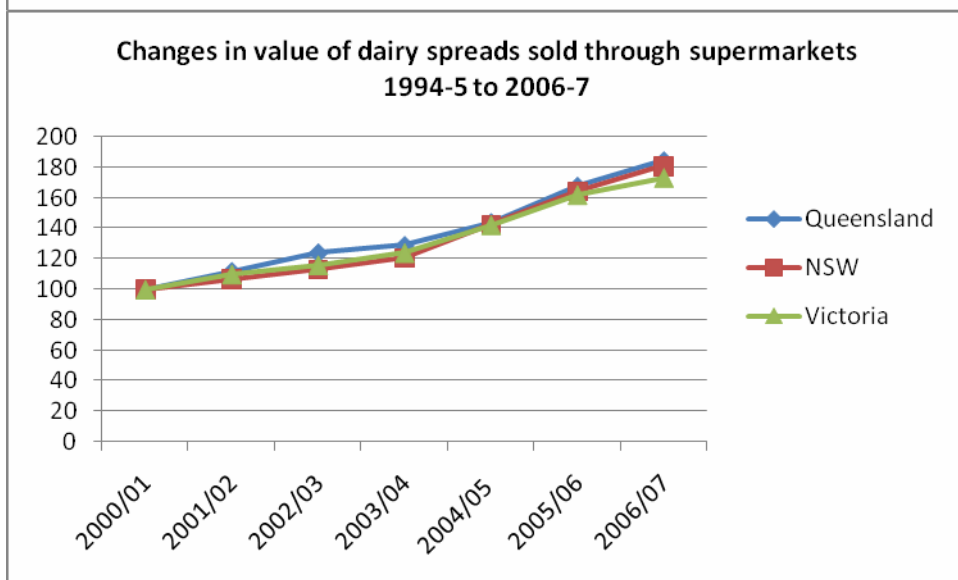
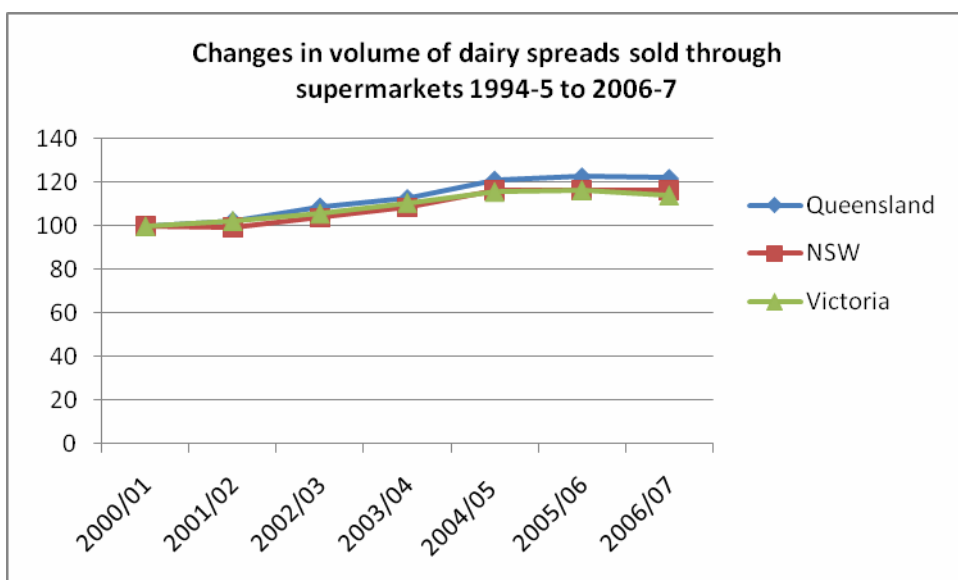
Data source: Dairy Australia



Graph 24 Cheddar cheeses are the largest component of supermarket cheese sales comprising 73.4, 68.3 and 70.8 percent in Queensland, NSW and Victoria respectively. In 2006-7 comparable retail value of non-cheddar cheeses was 60 percent higher than cheddar. Significant quantities of cheese are consumed through fast and other food outlets.

Data source: Dairy Australia

Dairy spreads



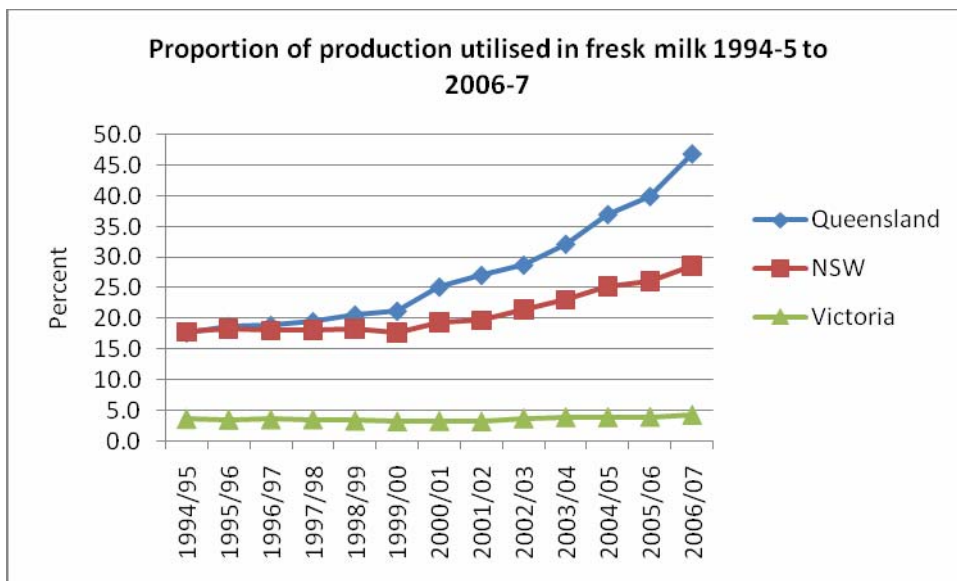
Graphs 25 & 26 Dairy spreads comprise both butter and butter vegetable oil (margarine) blends. This market is a low growth comprising about less than 2 percent per year, supermarkets have a greatly reduced bargaining power as much of blend production is limited to demand and the case of butter to export prices. Demand for these products is driven by health concerns around desirable fats for consumption in a daily diet. By and large a different group of export focused processors are supply sources. The fact that price movements are remarkably consistent would indicate a greatly reduced bargaining power. Prices have tended to rise by about 8 percent per year, which would reflect export demand.

Data source: Dairy Australia

Market supply

We would submit that owing to the narrow sighted pricing policies by the domestically oriented processors, being largely, Dairy Farmers (Group) Cooperative, National Foods Limited and Pauls Parmalat Limited have in their eagerness to accommodate the demands of the larger and dominant supermarket chains namely, Woolworths and Coles produced a supply crisis in the Queensland and NSW markets. That this is so is a situation entirely of their making.

Graph 27 shows supply changes and it is our prediction that if current trends continue then consumers in Queensland and NSW will pay sharply increased prices as greater quantities of raw milk will have to be carted from southern NSW and Victoria just to meet demand and this is not merely to meet seasonal fluctuations. The graph shows the dramatic change in the proportion of milk used in each market to provide drinking milk. The greater the proportion, the fewer processors and retailers then the greater is the supermarkets bargaining power.

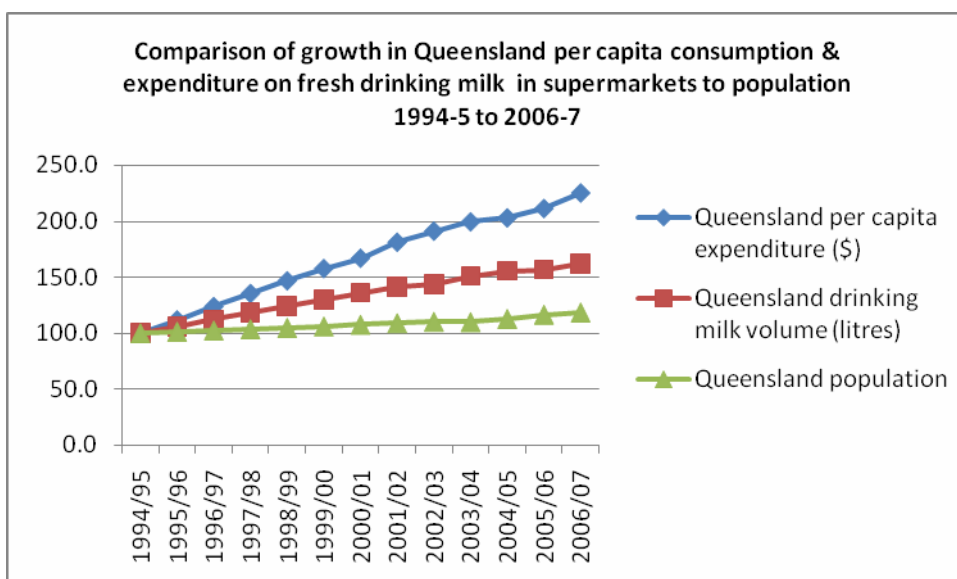


Graph 27 The proportion of milk used in Queensland for fresh milk is close to 50 percent, this is before any other fresh dairy products, yoghurts, creams and cheeses are supplied. The vast Sydney market is similarly affected. In Victoria the proportion of production used for fresh milk is less than 4.5 percent.

Data source: Dairy Australia

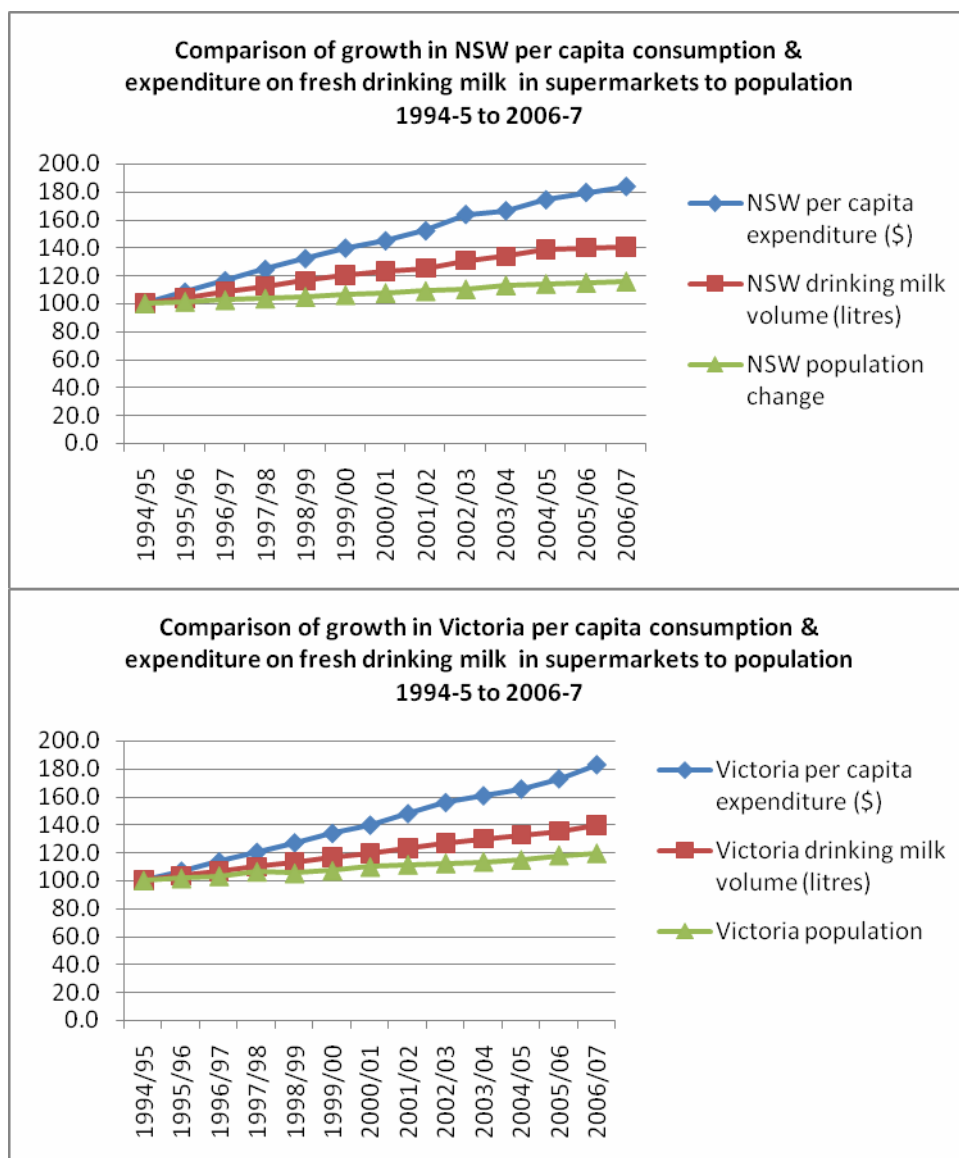
Supermarket dominance

The following Graphs 28, 29 & 30 illustrate the extent of growth in the volume of fresh milk, per capita expenditure compared to population growth in each of the three eastern states. This provides further evidence of the market dominance and the grip that major supermarkets hold over household expenditure.



Graph 28 Demonstrates the continued and steady growth in market share of by the major retailer chains when compared to rate at which this outstrips population growth. This market dominance and ability to set prices outside of market forces has a major effect on food prices and thus quality of life. There may have been some short term benefit to long term detriment.

Data source: Dairy Australia & ABS



Graphs 29 & 30

Continue comparison of the growth in supermarket dominance in NSW and Victoria. These graphs whilst they illustrate fresh milk the trends are replicated across all dairy products. Australian consumers spend an ever greater amount of their household food budget with major retailers. That this is so demonstrates the lack of competition and the extent of control back along the supply chain to the farm gate. The arrangements that permit this are made with witting and willing processors that in turn deprive consumers of true brand choice, the benefits of price competition and perhaps product quality. The greater the market dominance the less consumers benefit.

Data source: Dairy Australia

Truth-in-labelling and milk packaging

Since we have made our original submission and presented our earlier oral evidence there are some further matters upon which we wish to amplify being:

- ◆ Private (store) labels
- ◆ Use of permeate
- ◆ Farmers' attitudes, and
- ◆ Product descriptions.

Private (store) labels

In its recent review and outlook for 2008 Dairy Australia states:¹⁸

'...While private label accounts for a large share of drinking milk sales, the large grocery retailers are likely to take a more aggressive approach to the use of private label, particularly in other dairy products such as cheese and yoghurt.'

We have no issue with retailers developing private label brands, provided that in doing so they¹⁹:

¹⁸ Dairy Australia (2008), Dairy 2008: Situation and Outlook Summary Report

- ◆ Enhance competition
- ◆ Confer upon consumers the true benefits of a competitive market²⁰, and
- ◆ Provide real price advantage rather than merely be for exclusive supply arrangements between a retailer and a processor.

We contend that in terms of the foregoing point such arrangements generally:

- ◆ Act to exclude competitors
- ◆ Limit consumer choice
- ◆ Therefore constrain competition, and
- ◆ Deny consumers true price advantage.

Identifying the processor and location on food labels will greatly contribute to enhancing competition rather than being a tactic of *'split brand'* marketing and exclusive arrangements.

Use of permeate

Another important issue since we presented our evidence is that of the use of permeate in *'standardising'* fresh drinking milk. Consequently, Dairy Australia has issued two issues papers on this since the current affairs media enjoined issue with our evidence these are attached as Appendix 1.

Conclusively, consumers affirmed that they:

- ◆ Believed there was a difference in drinking milk attributes
- ◆ Ought to be able to make informed choices about products by knowing how, when and if they have been modified
- ◆ Should know whom a particular processor is for a particular private brand, and
- ◆ Know that dairy products are accurately labelled.

Farmers' attitudes

The New South Wales Farmers Association has affirmed their policy on truth-in-labelling in correspondence with us stating:

'...At the 2006 Annual conference the following resolution was passed:

That the Association lobby the Federal government for truth in labelling on all food products so the consumer can make an informed decision.'

In addition we submit that results of a survey conducted during March/April 2007 through a NSW-based dairy industry newspaper *'Dairy Digest'* add to the efficacy and need for truth-in-labelling. Respondents were asked to record their opinions to this question:

'...Would you like to see 'truth-in-labelling' legislation introduced by your state government? (For example retailers who have generic (house) brands must disclose on packaging who packaged the product and the accurate percentage of additives to modified products – please circle your opinion) - Yes or No or Don't know'

Opinion	%
Yes	= 90.1
No	= 1.2
Don't know	= 8.7

¹⁹ Australian Financial Review, 16 May 2008, reported that National Foods Limited had stated that 74 percent of milk sold in supermarkets is sold under house brands, further stating that house brands accounted for 57 percent of all milk sales

²⁰ The Age, 27 May 2008, reported that Coles Limited had stated that the same milk was used in all three tiers of their private labels and each tier had an increasingly higher price point

The significance is that dairy farmers hold in very high regard the integrity of their product, they want this reflected in the product reinforcement and in the continued building of consumer confidence in dairy products.

Thus truth-in-labelling is for them:

- ◆ Reinforcement of product quality and integrity
- ◆ The precise identification, source and specifications of ingredients comprising a product
- ◆ A statement of food and nutritional values
- ◆ Description of the nature and type of any processes undergone that may either alter or enhance a product, and
- ◆ The identity of any processor undertaking such processing either on their own behalf or that of a third party.

Next respondents to the survey had the opportunity to express an opinion in terms of the possible effect of truth-in-labelling and any mooted legislation by answering this question:

'...If such legislation were to be introduced do think the result would be to:

(a) Drive generic (house brand) prices closer to processor brand prices (please circle your opinion)

Yes or No or Don't know

(b) Lead to greater product differentiation (modified products) (please circle your opinion)

Yes or No or Don't know

Responses to question (a):

Opinion	%
Yes	= 53.1
No	= 16.0
Don't know	= 30.9

Responses to question (b):

Opinion	%
Yes	= 46.9
No	= 17.3
Don't know	= 32.1
No Opinion	= 3.7

The significance of these responses is that even though more varied they reinforce the high regard dairy farmers hold for their product quality and integrity and specifically that this ought to be followed through too to consumer choice.

The more varied response could be expected when asking such a question on marketing and consumer choice.

For each question $n = 81$, or 8.9 percent of the potential pool of respondents, a high statistical response.

Product descriptions

If and when permeate is used as is acknowledged for standardising drinking milk, see Appendix 1, then the issue arises consistent with truth-in-labelling as to whether a term such as '*standardised*' ought to be added and used.

Then too there is the issue as to whether when permeate is added should milk still be labelled with descriptors such as '*pure*', '*fresh*', '*full cream*' or '*whole milk*'. The use of the term '*standardised*' is no less accurate than present descriptions such as '*pasteurised*' and '*homogenised*' which are already used on milk

packaging. The term does not adversely reflect upon the nutritional value of the product but it does allow consumers to make an informed choice and to differentiate when making a purchase. In addition it can be anticipated that there could be a beneficial response from consumers against which both standards and price can be compared.

Conclusion

Fligstein (1996) argues that we should realise that markets are not places, but social constructions that reflect the political and cultural constructions of a nation and the businesses that comprise it. The creation of markets implies societal solutions to the issue of property rights, corporate and governance structures, conceptions of control and the rules of commerce. States, being governments, and markets are interconnected, and embark upon certain actions to produce outcomes. Nor are markets a series of amorphous transactions where price signals can either be quite clearly and intentionally transmitted or on the other hand deliberately obfuscated, where tacit collusion occurs.²¹

Deregulation of the dairy industry in 2000 returned to dairy farmers the absolute property right in the milk they produced. Since the 1930s this had been appropriated to the state by the various state governments when they enacted their milk acts. This control remained to varying degrees in each state until the National Competition Policy enforced the deregulation of the dairy industry. Exports were controlled through the Australian Dairy Corporation.

In states such as Queensland and NSW strong control existed, quota systems were used, a value applied to them and they were traded between farmers for the right to produce designated quantities of milk; farm gate prices were set by the state government dairy industry authorities and regulating body; retail prices were also regulated by price fixing authorities. Farm gate price increases were usually granted on the basis of an increase in the cost of production.

Dairy farmers and their representative organisations became very adept at rent seeking. Milk processors were virtually licensed to produce and distribute milk and dairy products. The dairy industry enjoyed protection and export incentives, and even the oilseeds industry and the related margarine industry were heavily restricted and regulated as a competitor to dairy spreads. The focus after deregulation has shifted from high cost quota-based production to that of getting unit costs down and maximising production.

In the 18 years leading up to deregulation, the controls over the dairy and other agricultural industries were gradually being relaxed. In 1982 the Fraser Government commissioned a report on the future direction of Australian agriculture, chaired by Sir James Balderstone. By the time the report was produced the government had changed, and it was the Hawke Government that introduced most of its recommendations.²² One of the principal recommendations, which was to transform all Australian agricultural industries, was the removal of all subsidies and the dismantling of all forms of protection. Australia should embrace free trade.

The outcome of this inquiry was the genesis of National Competition Policy. It has also led to the Australia's preeminent position in championing free trade, particularly in agricultural commodities. Arising from this leadership of the Cairns Group, which is a group of like minded nations that arose from the Uruguay Round of trade negotiations.²³ Australia's pursuit of free trade led to the Hawke Government entering into the Closer Economic Relationship (CER) with New Zealand, and then the Howard Government concluded free trade agreements with Thailand and the United States all of which have had beneficial outcomes for the dairy industry.

It is now eight years since the deregulation of the dairy industry, and as has been discussed; dairy farmers received a generous compensation or exiting package financed by a levy on the retail sales of drinking milk. Those remaining in the industry have grown in size. For much of the time since deregulation, protracted periods of drought have existed and this has had a significant impact. The

²¹ Fligstein, Neil (1996), Markets as Politics: A Political-Cultural Approach to Market Institutions, *American Sociological Review*, Vol. 61, No. 4 (Aug., 1996) pp 656-673

²² Balderstone, J S, L P Duthie, D P Eckersley, F G Jarrett and J C McColl (1982) *Agricultural policy: Issues and options for the 1980s* AGPS Canberra

²³ Stiglitz, Joseph E., Andrew Charlton (2005) *Fair trade for all: how trade can promote development*, New York: Oxford University Press

proportions of national dairy production are almost equally divided between exports and meeting domestic consumption.

Processors appear to focus production either on export markets or for domestic consumption, with no company appearing to have a significant presence in both spheres. This may be a weakness in the industry structure with the lack of diversification by Australian based companies and their institutional arrangements. It is probably too a carry over from pre-existing institutional arrangements. We would also suggest that it is particularly those focused on domestic production who have responded least to deregulation.

As a consequence of deregulation, the Australian Dairy Farmers' Federation (ADF) sought and was granted a collective bargaining authorisation. Little use has been made of it until recent amendments made to the Trade Practices Act. Our group operates under the auspices of the ADF authorisation.

As Fligstein (1996) hypothesises modern capitalistic governments create institutional arrangements to create stable markets. But to be affective markets must be contestable. We would argue that neither the domestic dairy processing sector nor the supermarket aspect of retailing is contestable, due to incredibly high barriers to entry.

'...Property rights, governance structures, and rules of exchange are arenas in which modern states establish rules for economic actors. States provide stable and reliable conditions under which firms organize, compete, cooperate, and exchange. The enforcement of these laws affects what conceptions of control can produce stable markets. There are political contests over the content of laws, their applicability to given firms and markets, and the extent and direction of state intervention into the economy. Such laws are never neutral. They favor (sic) certain groups of firms.' (Fligstein, 1996, p660)

We would strongly argue that pre-existing institutional arrangements allowed for the rise in the market dominance of major retail supermarkets chains, which always argue for a greater critical mass and for the bringing of economic efficiency and consequent benefits.

Fligstein (1996) also observes that there are two types of political constructs in markets, which affect firms, apart from governments themselves, being the internal power struggle and the struggle across firms to control markets. The internal struggle concerns who will control a firm, how it will organise itself, how situations will be analysed and responded to, and how to control competition.

'...a few firms can control the market by tacitly agreeing not to threaten one another's position through a price war. They often publicly announce pricing and production decisions so that other firms can follow suit.' (Fligstein, 1995, p 659)

Processors seek to control supply at a given price and enter into exclusive and collusive arrangements with major retailers to dispose of output with a two (or more) tiered pricing structure. Supermarkets buy at a favourable and beneficial price and on terms not available to many other buyers.

We would also say that processors cooperate with each other in order to share both markets and supply sources. By this, we mean packaging for each other and selling milk between them to either meet supply shortages or to save on costs, most notably at the farm gate.

Each of the major firms in the market we either deal with or respond to in the sale of our group's milk would argue against a challenge to the status quo, arguing that to do so would destabilise the market and bring with it chaos, and contending that the way things are done should remain, and that the conventional wisdom resides with them saying that they know the market. We argue too that these arrangements are far too easy and that a stable market through existing supply arrangements does not produce the best outcomes especially for suppliers and consumers. We argue too that these arrangements are reflected by low innovation rates with not a lot of new product development and that this lack of true competition is delivering higher prices for consumers and not fairer prices through true competition.

We would also argue too that we have experienced sharply increased input costs whether it is fertiliser, fuel, power and importantly grain. These will also impact on milk and other food prices. The effect of this on domestic food costs has yet to be fully played out, and will be long lasting, because the effects will be felt in all grain dependent livestock industries.

Some of this has been caused by the distortionary affects of American subsidies on ethanol grain production. Its impact is not only on world grain supply but on food shortages in the developing world; this is clearly feeding into Australian grain prices and now into food prices.²⁴

We would argue too that with ever growing fuel prices and environmental considerations food production in proximity to capital city markets, such as by our group, ought to receive a freight premium, as has been successfully argued for and obtained by companies such as Rio Tinto for export iron ore. ^{25,26} Future carbon trading too will impact on farm gate prices. Perhaps it is a question of both market and bargaining power.

'...Large firms control more external resources than small firms, including pricing from suppliers, financial assistance, and legitimacy.' (Fligstein, 1995, p 663)

We would submit that producers have not benefited financially from deregulation but in terms of their trading freedom they now can with changed bargaining arrangements. To date much of the financial benefits from deregulation have been captured by the major food retailing chains.

Whilst major retailers might point with some justification at their efficiency, the question ought to be asked: are consumers the true beneficiaries of their policies and practices? The answer has to be that in the long run it is their shareholders rather than their customers who benefit most.

Prepared and submitted by:
Kiama Shellharbour Albion Park Milk Suppliers Collective Bargaining Group
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²⁴ Stiglitz, Joseph E., Andrew Charlton (2005) Fair trade for all: how trade can promote development, New York: Oxford University Press

²⁵ Sydney Morning Herald, Rio shares rise on Chinese iron ore deal, June 24, 2008

²⁶ Sydney Morning Herald, Asian steel mills accept Rio's price rise, July 1, 2008