

# Chapter 1

## Introduction

1.1 On 25 June 2008, the Senate referred the following matter to the Select Committee on Agricultural and Related Industries:

Food production in Australia and the question of how to produce food that is:

- (a) affordable to consumers;
- (b) viable for production by farmers; and
- (c) of sustainable impact on the environment.<sup>1</sup>

1.2 The reporting date for the inquiry was 27 November 2009. The Senate has agreed to extend the final reporting date for this inquiry to 30 June 2010.

### Conduct of the inquiry

1.3 The inquiry was advertised in the *Australian*, major regional newspapers, and through the Internet. The committee invited submissions from a wide range of organisations and individuals. The committee resolved to accept submissions throughout the course of the inquiry.

1.4 The committee received 153 submissions. A list of individuals and organisations that made public submissions to the inquiry is at Appendix 1. To date, the committee has held fifteen public hearings on 4, 5, 24 and 25 March, 1 April, 19 May, 1 July, 31 August, 18 September, 6, 7, 12, 23 October and 18 and 24 November 2009.

1.5 The committee tabled its first interim report on 18 June 2009. The report focused on allegations made by Cuthbertson Brothers Pty Ltd, a major purchaser of sheep and lamb skins in Tasmania in respect of its commercial dealings with Swift Australia Pty Ltd, the largest meat processor in Australia.

1.6 The committee's second interim report, tabled on 27 November 2009, discusses a number of concerns raised in relation to proposed coal and gas exploration and mining/drilling on the Liverpool Plains area of NSW, in particular by BHP Billiton Ltd, Shenhua Watermark Coal Pty Ltd and Santos Ltd. Particular concerns were raised at the potential for these developments to adversely impact on agricultural activities in the area.

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1 *Journals of the Senate*, 25 June 2008, p. 7.

## **The committee's third interim report**

1.7 This third interim report discusses issues relating to the Tasmanian dairy industry, especially in relation to farm gate prices and contractual arrangements between suppliers and dairy companies, especially National Foods Ltd.

1.8 The committee received evidence related to the Tasmanian dairy issue at public hearings in Devonport on 6 October, Canberra on 7 October, 12 October and 18 November 2009 and Melbourne on 23 October 2009, details of which are at Appendix 2.

1.9 Other evidence on food production presented at the committee's other public hearings will be discussed in further reports by the committee.

## **Acknowledgement**

1.10 The committee thanks those individuals and organisations who made submissions and gave evidence at the public hearings held to date.

1.11 A brief description of the Australian dairy industry is provided below to provide a context for the inquiry.

## **Australian dairy industry**

1.12 The Australian dairy industry represents a large and diverse agricultural sector. More than nine billion litres of milk are produced annually in Australia by up to 8000 farmers. The milk is used in numerous products and is sold in a variety of markets.<sup>2</sup>

1.13 The dairy industry is one of Australia's major rural industries. Based on a farmgate value of production of \$4.6 billion in 2007/08, it ranks third behind the beef and wheat industries. It is estimated that approximately 40 000 people are directly employed on dairy farms and in manufacturing plants. Related transport and distribution activities, and research and development projects, represent further employment associated with the industry.

1.14 Dairy is also one of Australia's leading rural industries in terms of adding value through further downstream processing. Much of this processing occurs close to farming areas, thereby generating significant economic activity and employment in country regions. ABARE estimates this regional economic multiplier effect to be in the order of 2.5 from the dairy industry.

1.15 Dairying is a well-established industry across the temperate and some subtropical areas of Australia. While the bulk of milk production occurs in south-east corner of the country (80 per cent in the three states of Victoria, South Australia and

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2 *Submission 50A, Fonterra, p. 1.*

Tasmania in 2007/08), all states have dairy industries that supply fresh drinking milk to nearby cities and towns. A range of high-quality consumer products, including fresh milks, custards, yogurts and a wide variety of cheese types, are produced in most Australian states. Nevertheless, the manufacturing of longer shelf life products, such as cheese and bulk and specialised milk powders, is steadily becoming more concentrated in the south-east region of Australia.

1.16 Strong growth characterised the dairy industry through the 1990s, but that growth has not continued in recent years. The industry experienced a slow recovery from the severe drought of 2002/03, only to be impacted by dry conditions in recent years.<sup>3</sup>

1.17 Owner-operated farms dominate the Australian dairy industry, corporate farms make up just 2 per cent of the total, with share farmers involved in 18 per cent of local farms in 2007/08. The number of dairy farms has more than halved over the past 25 years, from 22 000 in 1980 to 7 950 in 2008. This reflects a long-term trend observed in agriculture around the world, as reduced price support and changing business practices have encouraged a shift to larger, more efficient operating systems.<sup>4</sup>

### ***Farm gate prices***

1.18 Unlike many countries around the world, there is no legislative control over the price milk processing companies pay farmers for their milk. Farmgate prices can vary between manufacturers, with individual company returns being affected by factors such as product and market mix, marketing strategies and processing efficiencies. Most milk prices are based on both the milkfat and protein content of the milk. Payments from processors to individual farmers can also vary marginally, as firms operate a range of incentive/penalty payments related to milk quality, productivity and off-peak supplies. There are also volume incentives in place to encourage milk supply to particular processing plants to improve operating efficiencies.

1.19 The price farmers receive also varies across states, reflecting how milk is used in the marketplace. For example, many farmers in the southern regions receive a 'blended' price, incorporating returns from both drinking and manufacturing milk. However, higher prices are often received for drinking milk under commercial supply contract arrangements in the northern dairy regions, where drinking milk makes up a much larger proportion of the production mix.<sup>5</sup>

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3 Dairy Australia, *Australian Dairy Industry in Focus 2008*, 2008, p. 9.

4 Dairy Australia report, p. 11.

5 Dairy Australia report, pp 12-13.

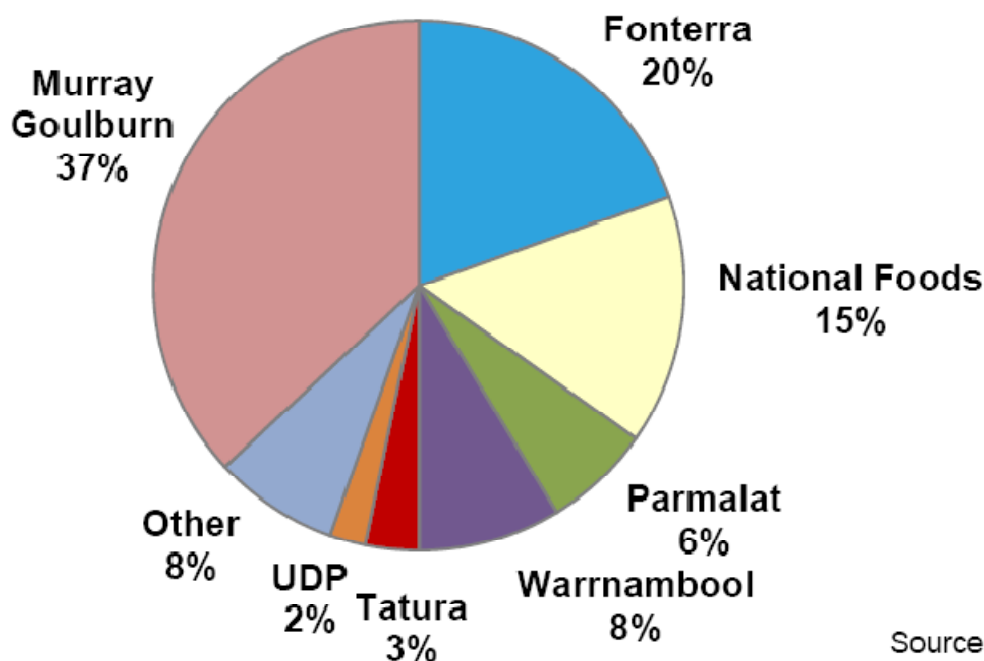
### **Milk production**

1.20 While farm numbers have steadily decreased over the past 25 years, milk output had generally increased, due to increasing cow numbers and improved cow yields up until the major drought of 2002/03. The underlying trend has continued to be that of fewer farms, larger herds, and increasing levels of milk production. Australian milk production decreased by 360 million litres, or 3.8 per cent, to 9 223 million litres in 2007/08. This reflected the continuation of difficult conditions around the country during the season.<sup>6</sup>

### **Dairy manufacturing**

1.21 The Australian dairy manufacturing sector is diverse and includes farmer-owned co-operatives, and public, private and multi-national companies. Co-operatives no longer dominate the industry, but still account for approximately 49 per cent of the milk output. The industry is highly concentrated with the largest co-operative (Murray Goulburn) accounting for 37 per cent of Australia's milk production, Fonterra 20 per cent and National Food 15 per cent. There are also a number of small to medium-sized co-operatives with milk intake volumes between 100 and 1,000 million litres, including Dairy Farmers, Norco and Challenge.

**Chart 1. Australian industry by milk volume (2008-09)**



Source: Dairy Australia

1.22 Other Australian dairy companies cover a diverse range of markets and products, from the publicly listed Warrnambool Cheese and Butter Factory, to Bega

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6 Dairy Australia report, pp 17-18.

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Cheese Limited and Tatura Milk Industries, to many highly specialised farmhouse cheese manufacturers.

1.23 Major multi-national dairy companies have operated in the Australian dairy industry for many years and currently include Fonterra, Kirin and Parmalat.

1.24 Around 60 per cent of manufactured product (in milk equivalent terms) is exported and the remaining 40 per cent is sold on the Australian market. This contrasts with drinking milk, where some 97 per cent is consumed in the domestic market.<sup>7</sup>

### ***Drinking milk***

1.25 The major players in the Australian drinking milk market are National Foods (Pura brand), Dairy Farmers (Dairy Farmers brand) and Parmalat (Pauls brand); together with a number of smaller players with strong regional brands.<sup>8</sup>

### ***Dairy markets***

1.26 While Australia accounts for an estimated 2% of the world's milk production, it is an important exporter of dairy products. Australia ranks third in terms of world dairy trade – with an 11 per cent share – behind New Zealand and the European Union.

1.27 Australian exports are concentrated in Asia, which represented 69 per cent of the total dairy exports value of A\$2.9 billion in 2007/08.<sup>9</sup> Japan is the single most important export market for Australia, accounting for 20 per cent of exports by value.

### **Deregulation**

1.28 Prior to 2000, when deregulation of the industry was introduced, the Australian dairy industry was subject to a range of state and Commonwealth legislation.<sup>10</sup> The drinking milk sector was regulated by State government legislation, and the manufacturing milk sector was governed by Commonwealth legislation. Historically, each State government had responsibility for the regulation and control of milk from vat to consumer. Dairy Authorities in each state regulated the sourcing, distribution and pricing of milk. Commonwealth marketing arrangements were aimed

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7 Dairy Australia report, p. 21.

8 Dairy Australia report, p. 26.

9 Dairy Australia report, p. 22.

10 Deregulation refers to the removal of both state and Commonwealth legislation specific to the dairy industry.

at supporting farmer incomes, and protecting the industry from the vagaries of international markets.<sup>11</sup>

1.29 In 1999, the industry's peak policy body, the Australian Dairy Industry Council (ADIC), approached the Commonwealth Government with a plan for an orderly, national approach to the deregulation of the drinking milk sector in conjunction with the end of manufacturing milk price support. In September 1999, the Commonwealth Government announced it would implement the Dairy Structural Adjustment Program (DSAP).

1.30 The DSAP involved the imposition of a (retail) Dairy Adjustment Levy of 11 cents per litre on consumers of products marketed as dairy beverages. The levy funded quarterly DSAP payments (over eight years) to Australian dairy farmers, to assist them to make the necessary adjustments to a deregulated environment, with minimal social and economic disruption.

1.31 For the states, deregulation led to the discontinuation of regulated sourcing and pricing of drinking milk. At the Commonwealth level, support of manufacturing milk prices through the Domestic Market Support (DMS) scheme ceased. The DMS, which operated from 1995 to 2000, supported the manufacturing milk sector by payments to producers for milk used in manufactured products. Farmers received payments for each litre of milk used in manufacturing products for sale on the domestic market.<sup>12</sup>

1.32 A Senate report into deregulation of the dairy industry stated that deregulation was supported principally by the large Victorian co-operatives and the United Dairyfarmers of Victoria. No other state supported market milk deregulation, nor was it supported by other dairy farmer organisations. The Senate report noted that Victoria was dominated by two co-operatives, which were heavily geared towards the export market and it was this export market exposure, which was the main commercial driver behind deregulation.<sup>13</sup>

1.33 As the last steps were taken in the deregulation process, all states repealed legislation governing sourcing and pricing of drinking milk, and the state milk authorities, which administered these controls, were wound up from July 2000.

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11 Dairy Australia, 'A History of Industry Regulation in Australia', <http://www.dairyaustralia.com.au>

12 Senate Rural and Regional Affairs and Transport References Committee, *Deregulation of the Australian Dairy Industry*, October 1999, p. 21.

13 Senate Rural and Regional Affairs and Transport References Committee, *Deregulation of the Australian Dairy Industry*, October 1999, p. 37.

1.34 Dairy Australia states that the impact of deregulation at the farm level was mixed:

[it]varied across the different states of Australia – very much dependant on how important drinking milk (with its regulated higher farmgate price) was to the individual farm enterprise in relation to their total milk production.<sup>14</sup>

1.35 Dairy Australia notes that a number of farmers took advantage of the exit payments offered under the DSAP scheme to leave the industry.<sup>15</sup>

1.36 Dairy Australia states that Australian dairy farmers now operate in a completely deregulated industry environment, 'where international prices are the major factor in determining the price received by farmers for their milk'. The only government involvement is in the administration of food standards and food safety assurance systems. At an average of approximately US34c per litre, Australian dairy farmers receive a low price by world standards and therefore have to run very efficient production systems.<sup>16</sup>

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14 <http://www.dairyaustralia.com.au>

15 <http://www.dairyaustralia.com.au>

16 <http://www.dairyaustralia.com.au>

