

Chapter 2

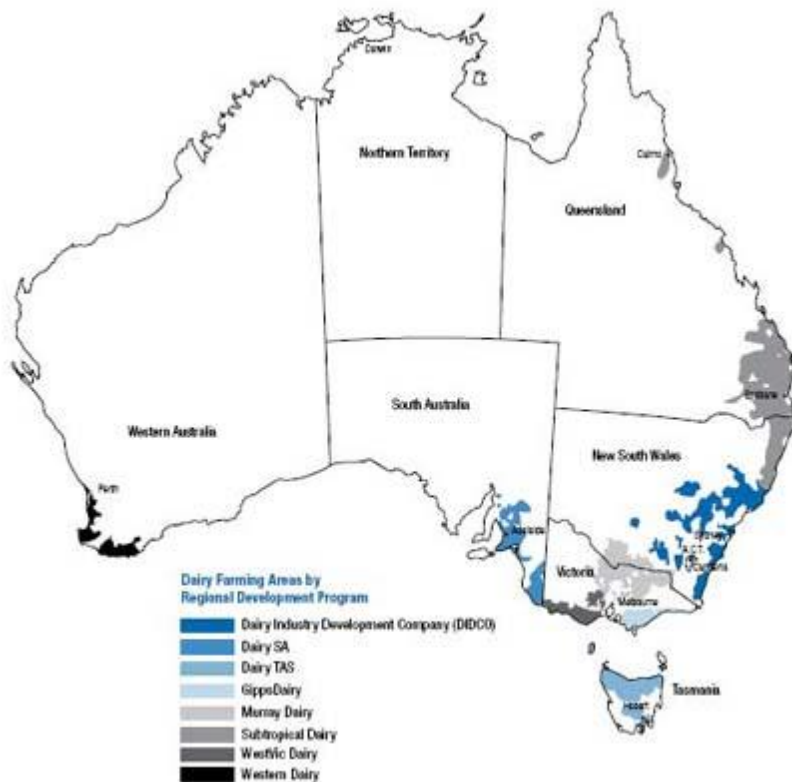
The Australian dairy industry

Description

2.1 The dairy industry is Australia's third largest rural industry. It consists of about 8,000 dairy farms and directly employs approximately 40,000 people.¹ It has a farmgate value of \$4 billion.² A reduction in dairy farm numbers since deregulation of the industry has been more than offset by an increase in average herd size and productivity, the effect being that the volume of milk produced by the 8,000 farms in 2009 is over 70 per cent above the volume produced by the 22,000 farms in 1980.³

2.2 Australia's main dairying areas are identified on the map below.

Chart 2.1: Australian dairying regions



Source: www.dairyaustralia.com.au

1 Dairy Australia, *Australian Dairy Industry in Focus 2009*, p. ii.

2 Dairy Australia, *Australian Dairy Industry in Focus 2009*, p. ii.

3 Based on data in Dairy Australia, *Australian Dairy Industry in Focus 2009*, p. 9.

2.3 Over two-thirds of the 9.4 billion litres of milk produced in 2008-09 was produced in Victoria, 10 per cent in New South Wales and 7 per cent in Tasmania.⁴ Dairying occupies a relatively large proportion of the agricultural sector in Tasmania.⁵

2.4 Australia's milk production sector is dominated by owner-operated farms (approximately 80 per cent).⁶ Although these farmers operate efficiently they remain vulnerable to unstable climatic conditions which in turn affect their ability to successfully manage the costs of production. Milk production is highly seasonal, peaking in October and tapering off in the cooler months from April (Chart 2.3 below).

2.5 Just over half the milk produced in Australia during 2008-09 was consumed by the domestic market; the remainder being exported as either drinking milk or manufactured products.⁷

Recent developments

2.6 In 2008, Dairy Australia reported that the Australian dairy industry was 'enjoying the best world market conditions in decades...international dairy commodity prices rose to record levels through 2007', due to consistent strong demand and tight supplies, as well as the effects of exchange rates and cuts in export subsidies.⁸ This led to higher farmgate milk prices for Australian dairy farmers – prices increasing by more than 50 per cent in southern regions during 2007-08 (see Chart 6.1).⁹ Dairy Australia did note that despite the optimism, the industry 'remain[ed] constrained by the high cost and limited availability of production inputs, uncertain climatic conditions and reducing dairy herd numbers'.¹⁰

2.7 Higher farmgate prices continued into the 2008-09 season until, following the global financial crisis, milk processors reduced the price paid to farmers sharply.

4 www.dairyaustralia.com.au *Milk Production Report*, viewed 16 February 2010.

5 In 2007-08 the value of Tasmania's livestock products (which mainly includes wool, milk and eggs) was \$413 million. Of this amount \$275 million was the estimated value of farmgate milk production (approximately 67 per cent). Source: Australian Bureau of Statistics 1307.6 – *Tasmanian State and Regional Indicators*, December 2009 – www.abs.gov.au; and www.dairyaustralia.com.au, *Dairy 2009 Situation and Outlook*, June 2009, p. 82.

6 Dairy Australia, *Industry Statistics – cows and farms*, www.dairyaustralia.com.au, viewed 8 March 2010.

7 About half of the domestic consumption is as drinking milk, the remainder being used in the production of cheeses, butter, and milk powders. Dairy Australia, *Dairy 2009: Situation and Outlook*, June 2009, www.dairyaustralia.com.au.

8 *Australian Dairy Industry in Focus 2008*, p. 3.

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

10 *Australian Dairy Industry in Focus 2008*, p. 3.

2.8 The reduction in price per litre paid to farmers was initiated by Murray Goulburn who announced a 'step-down' in response to the weakening international commodity market. Following Murray Goulburn's announcement, the remaining major milk processors also announced reductions in the price they would pay.

2.9 The economic effect on the dairy industry of these announced reductions in prices paid to farmers has been a focus of this inquiry, evidence gathered by the Committee indicating that the impact on dairy farmers and their communities has been severe:

In July, August, September and October, suppliers have lost substantial income. I myself am losing in excess of \$100,000 a month... There are individual examples of farmers having to sell furniture in order to put food on the table for their family and, in some circumstances, offering to hand their farms back to the bank. The first forced sale of a farm which supplies National Foods is taking place on 19 November.¹¹

Whilst we have had downturns of this nature to cope with practically ever since we have been involved in farming, this is by far the worst that we have ever had to deal with. I guess the main reason that it is the worst is that we were faced with a 40 per cent drop in milk price in January of last season. In terms of our operation, we are relatively big farmers, with 550 or 600 cows. That cut \$380,000 worth of income out of the last half of our business last season.¹²

On my calculations, losing 6c a litre equates to a combined loss of \$7.8 million across 90 suppliers in Tasmania. If you add a conservative multiplier of 2.5 to that loss, that translates into a regional economic impact of minus \$20 million. That is just a conservative estimate of economic loss. The social cost is almost impossible to quantify and the qualitative impact is real. It is not just employment loss; it is family breakdowns, bankruptcy and loss of life, sometimes in the most tragic circumstances.¹³

The economic effect on the dairy industry of reductions in prices to be paid to producers will be devastating to the industry and may see further farmer numbers being reduced as farmers are unable to receive a reasonable return (cost plus margin) to survive. ...farmers are being forced to supply the total Australian market at a price that relates to the conditions relative to commodity markets around the world...¹⁴

2.10 The step down in farmgate prices in 2008–09, the first such occurrence since 1973, led to a downturn in confidence within the industry from its 2008 optimism, albeit only back to somewhere around the longer-term average (Chart 2.2).

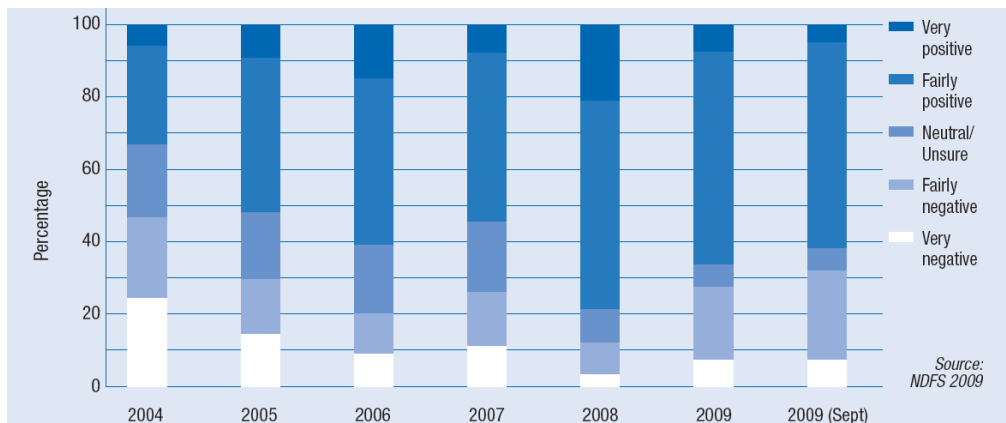
11 Mr Phil Beattie, Spokesman, Tasmanian Suppliers Collective Bargaining Group, *Committee Hansard*, Thursday 5 November 2009, p. 13.

12 Mr Wayne Tennant, *Committee Hansard*, Friday 6 November 2009, p. 48.

13 Dr Tony McCall, University of Tasmania, *Committee Hansard*, Thursday 5 November 2009, p. 41.

14 Amalgamated Milk Vendors Association Incorporated, *Submission 32*, p. 2.

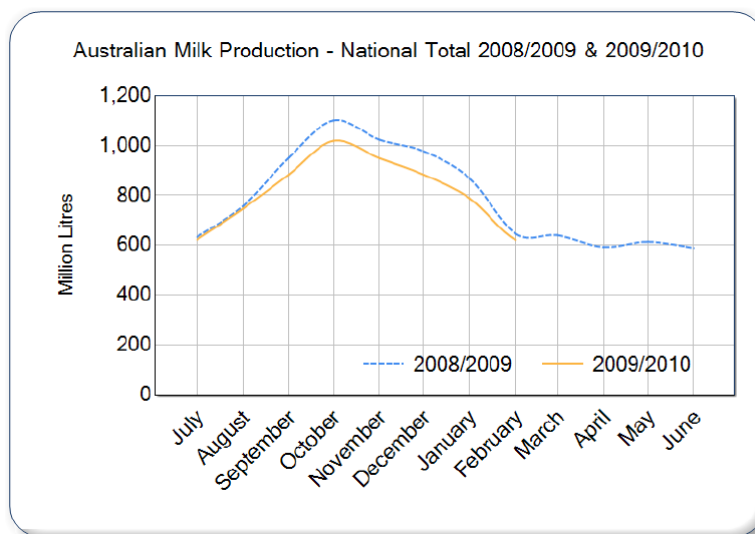
Chart 2.2: Farmers' attitude to the future of the dairy industry



Source: Dairy Australia, *Australian Dairy Industry in Focus 2009*, p. 5.

2.11 This has in turn been followed by a reduction in milk production.¹⁵ This year's production levels are tracking lower (Chart 2.3) and annual production is expected to return to the level of 2007-08 due to the lower prices, reduced demand and the effects of both drought and flood.¹⁶

Chart 2.3: Monthly milk production



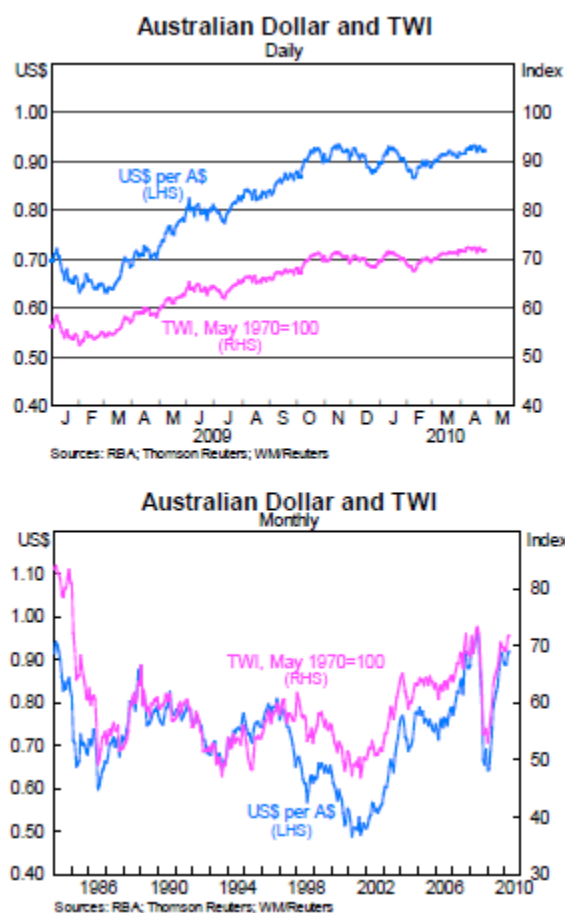
Source: Dairy Australia, www.dairyaustralia.com.au.

15 Dairy Australia notes that a large percentage of farmers affected by step downs intend to reduce their herd sizes and are likely to reduce their supplementary feeding. Dairy Australia also notes that in April 2009 cull or chopper sales increased for the 'fourth consecutive quarter...as farmers chose to offload livestock rather than go through autumn and winter with little feed and significantly reduced milk prices.' www.dairyaustralia.com.au, *Dairy 2009 Situation and Outlook*, June 2009, pp 63, 65, 76.

16 Dairy Australia, *The Dairy Australian*, September 2009, www.dairyaustralia.com.au.

2.12 Although the international market has shown signs of stabilising in recent months,¹⁷ the continuing appreciation of the Australian dollar (Chart 2.4) represents an additional challenge for the Australian dairy industry putting downward pressure on export returns.

Chart 2.4: Exchange rates



Source: Reserve Bank of Australia, www.rba.gov.au.

2.13 Dairy Australia predicts that global dairy demand 'based on continued economic recovery is likely to continue to improve over the course of 2010 in most key markets; albeit at a slower pace.'¹⁸ Caution remains however as any number of factors could negatively affect demand and cause a reduction in commodity prices.

17 Dairy Australia reports in their February 2010 update that both the United States and European Union have moved to remove export subsidies and have stopped buying local product to add to intervention stores.

18 www.dairyaustralia.com.au, *Dairy 2010 – Situation and Outlook – February 2010 Update*, viewed 14 April 2010, p. 6.

Committee view

2.14 The Committee recognises that the impact of the global financial crisis on the Australian dairy industry was severe. The Committee acknowledges that it will take some time for the industry, particularly dairy farmers, to recover and suggests that the Government consider its role in the industry's recovery particularly in terms of facilitating its long term sustainability.

2.15 The Committee has further considered these matters in Chapter 6 of this report.

Dairy industry deregulation

2.16 Until 2000, the Australian dairy industry was regulated. The price paid for manufacturing milk was determined by factors including world prices of manufactured dairy products, although support was provided through the use of national export pools that ensured farmers received an average pool price for their product regardless of its quality, use and destination.¹⁹ State authorities set the farmgate price for fresh drinking milk to ensure the additional costs of year round supply were covered. Today, however, Australia's dairy farmers operate in a deregulated and open market; the determination of prices is described in Chapter 3.

2.17 Steps towards market deregulation commenced in the mid 1980s and continued throughout the 1990s. Deregulation was largely driven by the dairy industry itself as participants sought opportunities for growth. On 28 September 1999 a government support package was announced to support all states in deregulating their dairy industries from 1 July 2000.²⁰

2.18 At the time deregulation was being considered, the Senate Rural and Regional Affairs and Transport References Committee investigated the domestic dairy industry with particular reference to market conditions, competitiveness, regulatory arrangements and measures that the government could take to facilitate a transition to a less regulated environment.²¹ Their comprehensive report, *Deregulation of the Australian Dairy Industry*, concluded that 'sooner rather than later the market [would] force deregulation and that a managed outcome with a soft landing [was] preferable to a commercially driven crash.'²² In their findings however, they also noted that of serious concern was the suggestion that the control regulation provided would 'shift to

19 Joint committee of the South Australian House of Assembly and the Legislative Council, *Joint committee on the impact of dairy deregulation in South Australia*, May 2003, p. 5.

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

21 *Deregulation of the Australian Dairy Industry*, October 1999, p. 170.

22 *Deregulation of the Australian Dairy Industry*, October 1999, p. 170.

processors and large retailers who would then be able to dictate terms to the industry and marketplace.²³

2.19 Following deregulation, the reduction in dairy farm numbers was coupled with an increase in herd sizes and milk yields per cow as farmers sought to benefit from the efficiencies of larger operating systems.²⁴ Similarly, there has been considerable consolidation within the processing sector as processors have experienced sustained pressure to reduce costs.²⁵

Increased concentration of processors

2.20 The manufacturing sector of the Australian dairy industry has become more concentrated since the first stages of deregulation in the late 1980s; the outcome being increased foreign ownership and a reduction in the market share of farmer owned cooperatives. The five major companies have increased their milk processing capacity from 50 per cent to 75 per cent of the market.

2.21 In 1999, the five largest milk manufacturers in Australia were Murray Goulburn, Bonlac, Dairy Farmers Group (all three entities were cooperatives), National Foods Ltd and Pauls/Parmalat.²⁶ Pauls/Parmalat, National Foods and Dairy Farmers Group dominated the market for drinking milk sales (cumulatively they held an 80 per cent share of this market) while the cooperatives of Murray Goulburn and Bonlac dominated the manufacturing milk market, the two entities responsible for processing 55 per cent of all Australia's manufacturing milk.²⁷

2.22 Today, Bonlac is owned by Fonterra, and the Dairy Farmers Group has been acquired by National Foods. Fonterra (20 per cent), together with Murray Goulburn (the largest remaining farmer owned cooperative, supplying 37 per cent of Australia's milk) are the prominent market players in the manufacturing milk market (Chart 2.5).

23 *Deregulation of the Australian Dairy Industry*, October 1999, p. 170.

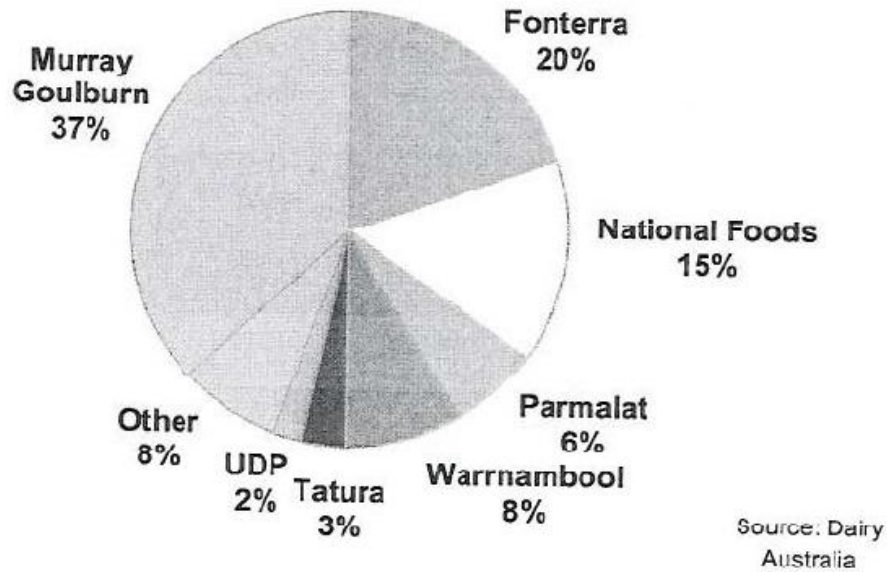
24 Dairy Australia, *Australian Dairy Industry in Focus 2009*, www.dairyaustralia.com.au.

25 www.dairyaustralia.com.au, *Dairy 2010 – Situation and Outlook – February 2010 Update*, viewed 14 April 2010, p. 11.

26 Senate Rural and Regional Affairs and Transport References Committee, *Deregulation of the Australian Dairy Industry*, October 1999, p. 8.

27 *Deregulation of the Australian Dairy Industry*, October 1999, p. 19.

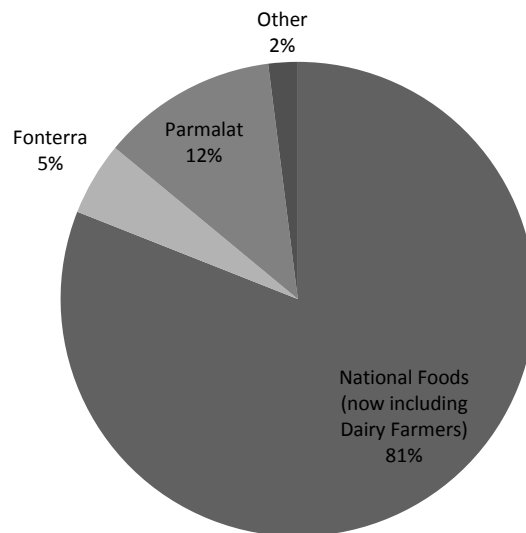
Chart 2.5: Market share of milk volume (2008-09)



Source: Fonterra, *Submission 10*, Attachment 1, p. 2.

2.23 The remaining milk produced in Australia is sold into the domestic drinking milk market which, like the manufacturing milk market, is dominated by two players – National Foods and Parmalat (Chart 2.6).

Chart 2.6: Share of drinking milk market



Source: Figures from AMVA, *Submission 32*, p. 3.

2.24 Milk sold into the drinking milk market is marketed through various channels including fast food outlets, supermarkets, independent grocers, corner stores, and service stations. However, the sale of milk through the supermarket channel has slowly been increasing; Dairy Australia noting a recent change in the behaviour of the

two large chains – they have embarked on a marketing campaign encouraging consumers to make comparisons between their own generic branded milk with that of branded products.²⁸ Dairy Australia comment that although this behaviour is 'unlikely to affect the volume of dairy products consumed there may be an impact on the channel and value of dairy sales as consumers seek greater value in their purchases' and move to generic labelled and price discounted branded products.²⁹

Committee view

2.25 The Committee notes with concern the increasing market share of the major retailers in the drinking milk market through their sale of generic milk. The Committee wishes to bring this situation to the attention of the Government, particularly as the processors dominating the fresh milk market are directly competing with their own products as they also supply Woolworths and Coles with their generic branded milk. This situation suggests to this Committee that the 'serious concern' of the Senate Select Committee which undertook the 1999 inquiry into deregulation of the industry that the control regulation provided would 'shift to processors and large retailers who would then be able to dictate terms to the industry and marketplace'³⁰ has been realised to the detriment of the industry as a whole and the consumer. The Committee has further explored these issues with a view to addressing the concerns in Chapters 3, 4 and 5.

28 www.dairyaustralia.com.au, *Dairy 2010 – Situation and Outlook – February 2010 Update*, viewed 14 April 2010, p. 12.

29 www.dairyaustralia.com.au, *Dairy 2010 – Situation and Outlook – February 2010 Update*, viewed 14 April 2010, p. 12.

30 *Deregulation of the Australian Dairy Industry*, October 1999, p. 170.

