NATIONAL COMPETITION POLICY AND THE AUSTRALIAN DAIRY INDUSTRY

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> The Committee believes that the time has come to progress regulatory reform more broadly, and to do so by *reversing the onus of proof* in considering the desirability of reforming particular regulation. Consistent with the principles already agreed between governments, in relation to market conduct, the Committee considers there should be *no regulatory restriction on competition unless clearly demonstrated to be in the public interest* (Hilmer *et al*, 1993: 190) (emphasis added).

National Competition Policy (NCP) was an important part of the Hawke/Keating federal Labor Government's free-trade oriented 'regulatory reforms' which led, amongst many other major changes, to dairy market deregulation. NCP was the vehicle by which corporate interests, sectors of the Australian Government and some dairy industry heavyweights[1] sought to achieve their combined free-trade, free-market agenda.

The main argument supporting NCP is that it creates a net community benefit. This paper argues that the real goals of NCP were tied to increasing corporate market power and profitability, and that public interest arguments against deregulation were not given proper consideration if they stood in the way of the wishes of existing big businesses or potential corporate investors. Substantial as the 1995 NCP changes were, public debate on NCP has been limited to the margins. The fact that mainstream media has given scant coverage to such a major

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1 Such as Victoria s Murray Goulburn Co-operative and Bonlac Foods (WA Legislative Council Hansard June 2000: 7924).

policy change is evidence of their own lack of understanding of its processes and implications.

Much Australian literature devoted to the imperatives of 'globalisation' does not bring in the domestic implications and linkages. Bob Catley's *Globalising Australian Capitalism* provides a semi-critical explanation, from a Labor insider's perspective, of the reasons such policy changes were implemented (Catley 1996). Ann Capling's *Australia and the Global Trade System* describes Australia's adoption of the global free trade agenda but, like Catley, makes no specific mention of NCP (Capling 2001).

More than a decade after its introduction, this article uses the example of the deregulation of one of Australia's most valuable rural industries, dairy, to reveal the means by which the corporate focus was embedded in NCP. It revisits the NCP proponents' case for change and assesses the strength of that original case for deregulation against currently available data on outcomes in the dairy sector. Previous research on the social impacts of dairy deregulation includes *Kin, Cows and Capital* (Anderson 2004) and *Taking Stock: farmers' reflections on the deregulation of Australian dairying* (Cocklin & Dibden 2002). In order to focus more attention on the wider social impacts, this article challenges the assumptions that the economic benefits of NCP are so obvious that any social (or environmental) costs need not be considered.

Apart from its regional implications, reasons for the level of public controversy over dairy market deregulation include the fact that milk and dairy products are a dietary staple, with almost half of Australia's milk and dairy produce still consumed domestically (Spencer 2004: 9). Moreover, in 1999, dairy was Australia's largest rural industry at the wholesale level, valued at around $7 billion per year, $2 billion of which was export earnings (SRRATC 1999: 5). Demand for market milk is inelastic because, whilst there are other options such as long life milk, powdered milk or soy, Australian consumers generally continue to prefer the fresh product (Dairy Australia 2006: 11).

How has the dairy industry been affected by NCP? This article looks at the nature of NCP and its main driving forces, in particular, the role of Paul Keating (as both Treasurer and then Prime Minister), powerful sections of the federal bureaucracy and big business as well as the connections of NCP to corporate globalisation/free trade. It sets out some main assumptions of the proponents of dairy deregulation, the nature of the public interest assessment process, a comparison of the economic and social positions of the dairy industry against the predicted outcomes of deregulation, and concluding implications.

Background

According to the former Australian Ambassador to the General Agreement on Tariffs and Trade (GATT), Donald Kenyon (Kenyon & Lee 2006: 55), it was on the instigation of Trade Secretary, Vince Fitzgerald, that Trade Minister, John Dawkins inaugurated the meeting of 14 agricultural exporting nations in Queensland, to push for agricultural free trade leading into the Uruguay Round of the GATT. Fitzgerald argued that this could be a means by which Australia could 'punch above its weight' in the GATT trade negotiations. This group of agricultural exporting nations promoting agricultural free trade became known as the Cairns Group, named after the location of its inaugural meeting. By July 1988, the Cairns Group had submitted a proposal on agricultural trade liberalisation calling for the elimination of all production or consumption subsidies affecting agricultural trade (CUSCBO 1998:1).[2]

The leadership position taken by Australia in the Cairns Group was reflected in the way that it set up NCP and the subsequent way the NCP public interest process was treated in relation to agricultural marketing arrangements such as dairy. This desire of the Hawke/Keating Government to 'punch above their weight' in trade negotiations saw them attempting to lead the way by introducing competition policy to target domestic industry assistance and regulatory controls. However, competition policy, although discussed, did not form part of the GATT and, since then, in 2004, has been taken off the trade talks agenda by the General Council of the World Trade Organization (WTO 2007). As well as introducing NCP domestically, the Australian Government reduced

2 A further explanation of the links between trade and competition policy is provided in Margetts (2001:23-30).

tariffs in a range of industries prior to the Uruguay Round of GATT coming into force, some might say assuming naively that such actions would so impress the rest of the world that they would follow suit.

What is National Competition Policy?

National Competition Policy was a major policy change formally introduced in 1995 under the Keating Labor Government, following a range of reports and recommendations from the Industry Commission (and its precursor, the Industry Assistance Commission), and then the Independent Committee of Inquiry into National Competition Policy (the Hilmer Inquiry). The implementation of NCP included changes to the *Trade Practices Act* to bring many aspects of Government under the jurisdiction of the Australian Competition and Consumer Commission (ACCC) and major policy changes embodied in a set of agreements between the Commonwealth and the States. The agreements set up new and powerful bureaucratic structures, such as the National Competition Council (NCC)[3], forged new from old, such as the ACCC from the Prices Surveillance Authority and the Trade Practices Commission, and inserted the rules of global free trade and free market ideology into the local economy.

In 1995, Hilmer stated that the economic logic on which competition policy is based was still being formulated (Hilmer, 1995; 24). Writing in this journal in that same year, Patricia Ranald described the direction of NCP and pointed out a number of potential problems associated with its corporate focus, especially for service provision (Ranald 1995).

Others, like Morgan, whilst acknowledging its impact on Australia's most vulnerable groups and individuals, support NCP's economic tenets. Morgan describes NCP as a 'meta regulatory system' of unprecedented scale, scope and comprehensiveness (Morgan 2003:10), with powers akin to that of a constitution which can place 'extra-political constraints' on legislation and lawmaking by way of 'economic adjudication' (*ibid*:

3 Significantly, the inaugural staff of the NCC were mostly seconded from the Federal Treasury and the Productivity Commission (formerly the Industry Commission) (Morgan 2003: 122)

27), and powerful enough to enforce economic rationality (*ibid*: 72). However, whilst Morgan acknowledges that NCP was sponsored and promoted by a coalition of business interests and technocratic officials (*ibid*: 50) and driven politically by the Right faction of Labor (*ibid*: 64), she uses terms such as 'objective' and 'neutral' to describe NCP's economic rationalist power structures, appearing to support their overriding of democratic processes:

> The economic rationality of cost-benefit analysis which dominates meta-regulatory regimes lays claim to an objectivity and neutrality which will temper the arbitrary exercise of political power (*ibid*: 31).

Taking a more critical approach, in his submission to the *Senate Select Committee on the Socio-Economic Consequences of NCP* in 1999, John Quiggin included the following warning relating to the possible impact of NCP on the rural sector:

> The processing of agricultural commodities is an industry characterised by scale economies and market power. The result is that large numbers of farmers deal with a relatively small number of firms engaged in processing and marketing. In the absence of regulation or of frameworks for collective negotiation over prices, processing firms will be able to set prices paid to farmers far below the level that would prevail in a competitive equilibrium (SSCOSCNCP 1999: 1066).

So what drove the Government to introduce such a major policy change?

Drivers of NCP

The 2003 Productivity Commission publication, *From Industry Assistance to Productivity: 30 years of 'the Commission'*, lists a range of Industry Assistance Commission reports from its inception in 1974, relating to statutory marketing arrangements (PC 2003: 137-148). During the 1980s, the recommendations from these inquiries generally moved away from monitoring and reporting on industry policy to focus on recommendations to remove industry assistance and regulatory control (PC 2003: 2).

Following the 1981 publication of *Australian Financial System: Final Report of Inquiry into the Australian Financial System* (the ‘Campbell Inquiry’), the 1983 election of the Hawke Labor Government saw a significant shift in government policy.[4] The leaders in the Hawke Government were influenced by the intellectual climate at the time that strongly supported microeconomic reform, especially tariff reduction and financial deregulation. The bipartisan political support for these changes meant that the debate and public scrutiny of such policy directions was limited (Quiggin 1996: 28). The Hawke Government’s first major policy reform involved the floating of the Australian dollar and the abolition of exchange controls in December 1983. The Productivity Commission quotes Ross Garnaut:

The floating currency and removal of exchange controls, the dismantling of most protection in a series of decisions from 1983, and a wide range of other reforms to remove structural rigidities, raise productivity and strengthen the educational base, marked a sharp break from earlier Australian policy (PC 2003: 46).

The Hawke/Keating Government clearly recognised there would be ‘winners’ and ‘losers’ from such a major departure from past policies and approaches and found ways to give the whole process a corporate focus by involving them in policy development:

> The Government harnessed the support of the industries and interests that stood to gain from the reforms by enhancing their political power through its ‘recognition’ of ‘peak’ interest groups; it sought to lower the resistance of potential ‘losers’ by structural adjustment assistance and ‘compensation” (PC 2003: 58).

Federal Treasury, under Paul Keating, took over the responsibility for oversight of the Industry Assistance Commission in 1987 from the Department of Industry and Commerce (PC 2003: 27) and it is

4 The political origins of this policy direction can be traced back to senior government officials and key members of the Whitlam Government, including Bill Hayden (Strangio 2002).

significant that Keating invited big business allies to assist in the Industry Assistance Commission's Inquiry into Government (Non-Tax) Charges (IAC 1989). This report effectively became a big business wish list of how to reduce regulatory impediments to investment and increase corporate profits.

Leading into the Hilmer process, in 1990, Treasurer Paul Keating also commissioned the Industry Commission to conduct targeted inquiries into Statutory Marketing Arrangements for Primary Products, and into the specific sectors such as the Australian dairy industry, echoing the Cairns 'leadership' approach. In dairy, this project meant targeting State based statutory arrangements for milk production that regulated price, quality and quota of domestic market milk.

In its report on Statutory Marketing Arrangements (SMAs), the Commission's assumptions were expressed in general discussion about the effects of SMAs under the broad headings of 'efficiency effects on producers and buyers', 'wider economic effects' and 'social and environmental effects' (IC 1991a: 75-99).

Without factoring in any major changes to the market power in the retail or processing sectors as a result of deregulation, the Commission's predictions of the price effects of deregulating the dairy industry can be summarised as follows:

- The overall price distorting effects of SMAs were found to be relatively small and their removal in the combined dairy, sugar and rice industries was estimated to lead to an expansion in 0.03% of GDP.
- Domestic prices would be lower (estimated 30% decline in the price of market milk) and, as it was assumed that domestic marketing arrangements constituted an export subsidy, dairy exports were predicted to decline by 80% and, as a result, total output of the dairy industry to decline by 10%.
- Dairy manufacturing employment was estimated to decline by 10% but, as domestic market milk consumption was predicted to rise, this would lead to a slight expansion in output and employment in that part of the industry (IC 1991a: 230).

These views are reiterated in the Commission's report specifically on the dairy industry released later that same year (IC 1991b: xv):

Modelling work undertaken for the Commission on the effects of implementing its recommendations in the medium term (about five years after implementation) and the Commission's own analysis indicate that:

- The farm gate price of manufactured milk would decline between 5 and 9 percent, or 2 to 3 cents per litre;
- prices of manufactured dairy products would fall by around 12 percent as market support payments are reduced;
- the farm gate price of market milk would decline by more than one third, or around 12 to 15 cents per litre;
- the reduction of the farm gate price would allow a similar reduction in the retail price of fresh milk;
- total milk output would likely contract by around 5 percent; and
- Australia would remain a net exporter of dairy products.

Those predictions had influence on the way that decisions were made regarding dairy market deregulation and, in particular, on the formulation of the Hilmer report leading to the implementation of NCP. They will be revisited later in this article and compared to the economic and social outcomes actually experienced since that time by the Australian dairy industry.

The Hilmer Inquiry

National Competition Policy did not appear by public demand. In October 1992, less than a year after taking over as Prime Minister, Paul Keating commissioned an Independent Committee of Inquiry to conduct an inquiry into NCP. The committee consisted of three members: the Chair, Professor Frederick Hilmer, Dean and Director of the Australian Graduate School of Management, and Members, Mr Mark Rayner, Director and Group Executive of CRA Ltd, and Mr Geoffrey Taperell, International Partner, Baker and McKenzie. *National Competition Policy - The Report of the Independent Committee of Inquiry* (the Hilmer report) was published in August 1993.Taking the many unproven Industry Commission predictions and assumptions as given, the Hilmer Report's recommendations incorporated much of the corporate wish list as expressed in the Industry Assistance Commission's recommendations, such as the targeting of specific sectors of the economy:

> While trade policy reforms have increased the exposure of the internationally traded goods sector to competition, many goods and services provided by *government businesses*, some areas of *agriculture*, the *professions* and other important sectors are sheltered from international competition. Increasing *competition* and *efficiency* in these sectors requires more sustained attention to domestic constraints on competition (Hilmer, 1993: 11) (emphasis added).

One of the most significant (but probably least understood) recommendations adopted from the Hilmer report was the agreement to '…*review and, where appropriate, reform all existing legislation that restricts competition…*' (NCC 1998: 19), unless a successful case for public interest could be mounted. Nearly 2000 pieces of Federal, State and Local Government legislation and regulations were identified for review, overseen by the National Competition Council. It was then up to State and Territory Governments to conduct legislative review processes for their own legislation and to amend or repeal legislation or regulations which were considered to restrict competition unless an argument could be successfully mounted that the benefits of the restriction outweighed the costs and those objectives could only be achieved by restricting competition (NCC 1998: 19). The States and Territories agreed to a staged payment system ('tranche payments') from the Commonwealth, based on whether the NCC considered that they had made satisfactory progress on NCP legislative reviews and reforms (NCC 1998: 36-37).

Industry and community groups needed to mount a public interest case at their own expense if they wished to retain regulations. Having done so, theoretically, the power was allocated to the States and Territories to make their own judgements. But if the outcome of any review was not what the NCC decided ahead of time was their preferred nationally consistent approach, in line with the Industry Commission/Hilmer position, they would find fault with the review process, using the threat of recommending to withhold Commonwealth tranche payments to get their way or punish the States until they acquiesced.[5] The NCP legislative review process, driven by the NCC and overseen by Federal Treasury, has placed far more emphasis on theoretical market and free trade/investment outcomes (based on untested, and often faulty assumptions) and a nationally consistent approach as desired by the potential 'winners', than on the arguments of State or regional public interest. Morgan refers to the NCC's 'blunt hostility' to the public interest clause of the Competition Policy Agreements, and she reinforces this with the following quote from leaked correspondence from the NCC:

> The rationale underlying the competition policy agreements is the presumption that enhancing competition is generally in the public interest. As a consequence, the Council does not see a requirement for a government to formally examine the matters in clause 1(3) of the Competition Principles Agreement on every occasion that it implements reform (Morgan 2003: 124). [6]

The irony in relation to dairy farmgate deregulation is that, of the five States that undertook the public interest review processes in 1998, the public reviews from the majority of those States (New South Wales, Queensland, Western Australia and Tasmania) recommended that there was a public benefit in retaining farmgate regulations (JCIDSA, 2003:10). However, Victoria, a State which had already undergone a degree of dairy deregulation and whose dairy sector was mostly geared to the manufactured milk market, chose to remove dairy farmgate regulatory arrangements. This decision was not without controversy, even though Victoria's dairy producers were already producing the majority of Australia's milk and were hoping for an increase in their farmgate prices as a result. Industry interviews (Cocklin & Dibden 2002) reveal that, despite over 80% of Victorian farmers voting in favour of deregulation, the Victorian dairy industry opinion was divided between

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5 For an explanation of the NCP public interest process, and some of the difficulties involved in mounting a successful public interest case see Margetts (2001: 55-59).

6 Morgan sourced this quote from a union submission to the 1995 House of Representatives Standing Committee on Banking, Finance and Public Administration *Inquiry into Aspects of the National Competition Policy Reform Package*, Volume 6: 817.

those who saw deregulation as a good thing, those who grudgingly saw it as inevitable but were worried about the Commonwealth's threat to withhold compensation if they voted NO, and those who did not agree that farmgate deregulation was the right answer. South Australia followed Victoria's lead and agreed to deregulation in 2000 (JCIDRSA 2003:10-11). The Commonwealth set about to force the changes, regardless of the views of the majority of States or implications for particular regions.

Prior to farmgate deregulation, the deregulation of the Australian dairy industry had occurred in stages. Before 1986, pooling arrangements existed for both domestic and export milk produced in Australia (SRRATRC 1999: 20). In 1986, John Kerin, Minister for Primary Industry in the Hawke/Keating Labor Government, introduced a new market support scheme with the intention of making the dairy industry more market oriented. Between 1986 and 1992, export support was wound down from 44.2% to 22% above world parity prices (*ibid*: 21). This action was followed in 1991 by the Crean plan, prompted by findings from Industry Commission inquiries into rural marketing arrangements and the dairy industry in particular, which saw the extension but gradual reduction in export assistance from July 1992.

This reduction in dairy export assistance coincided with a range of export tariff reduction schemes in Australia that were associated with the April 1994 signing of the Uruguay Round of the General Agreement on Tariffs and Trade (GATT). Australia's commitments to the World Trade Organization (WTO) under this agreement required the termination of export subsidies (domestic industry assistance was still permitted but it was required to be unconnected to export sales). The Crean Plan for market assistance for dairy exports was subsequently stopped on 30 June 1995, and replaced by a Domestic Market Support Scheme (DMSS). This supported the domestic manufactured milk sector plan (*ibid*: 21).

Up to mid 2000, each State had regulatory arrangements for market milk quota or pooling arrangements and the setting of farmgate prices for market milk to help ensure year-round, reliable and adequate supplies of fresh milk and an equitable sharing of the higher farmgate prices which market milk attracted compared to milk used in manufacturing. For instance, the WA dairy industry operated under a quota and market regulatory system administered by the Dairy Industry Authority of Western Australia (*ibid*: 31).

Dairy deregulation effectively meant that the State-based dairy statutory bodies for market milk would be abolished, along with it the ability of the State to negotiate prices and quotas for market milk with stakeholders that would ensure its reliable supply. That meant that the dairy processing and the corporate retail sector would have much greater control over farmgate prices for market milk. Having removed the negotiated market milk premium, the farmgate prices for Australian market milk would now also be linked to export prices[7] that generally fail to factor in domestic supply constraints, such as drought.

In a submission to the Minister for Agriculture, Forestry and Fisheries (SRRATC, 1999: 5), the Australian Dairy Industry Council provided a 'snapshot', as of 14 April 1999 of a dairy industry which:

- Has export earnings of $2 billion in 1998/99
- Supplies 12% of world dairy trade (third largest dairy trader after the EU and NZ)
- Is Australia's third largest rural industry in value at the farmgate (behind beef and wheat)
- Is the largest rural industry valued at the wholesale level ($7 billion)
- *Has efficient milk production costs by world standards*
- Exports over 50% of total milk production
- Produces 10 billion litres of milk – a 55% increase since 1986, and 6% average annual increase during the 1990s
- Has 13,500 dairy farmers – a 30% reduction since 1985 (19,342) – with approximately 98% of dairy farms in family ownership
- Average farm size (now 180 hectares) and average herd size (now 149 cows) have doubled since the 1980s

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7 As there is no one international milk price there is some discretion in the price to which farmgate prices would be linked.

- Has seen dairy companies invest $1.5 billion to expand manufacturing capabilities in the five years to 1998
- *Is an important regional employer (60,000 direct jobs at farm and manufacturing level)*
- *Has 75% of Australia's milk production processed by dairy farmer owned cooperatives*
- Has 45% of all milk intake and 50% of all milk used for manufacturing controlled by the two major dairy co-operatives (Bonlac Foods and Murray Goulburn, both Victorian based)[8]

  (Emphasis added)

This 'snapshot' argued for the relative importance and strengths of the Australian dairy industry prior to deregulation. One important economic (and public interest) question this submission raises is whether deregulation has resulted in a stronger or more efficient dairy industry.

Data from across the Australian dairy industry, published by Dairy Australia and the Australian Bureau of Agricultural and Resource Economics (ABARE), indicates that total factor productivity began to drop off after deregulation. But both Dairy Australia and ABARE seem to have difficulty admitting that outcome. Instead of talking of the reasons for the drop off in productivity from 2000, ABARE talk of the slowing of average (total factor) productivity growth over the decade to 2003/04. The following quote illustrates the roundabout way that ABARE explains this development:

> Although dairy farmers achieved average growth in output of 5.3 percent a year over the decade to 2003-04, they obtained this by increasing their use of inputs, on average, by 4.4 per cent a year. As a result, the average rate of growth in total factor productivity slowed to 1.0 per cent a year (ABARE 2005: 3).

That is, the measured index of the volume of total otputs divided by the index of total outputs declined as a result of changed management

8 In July 2002, New Zealand milk giant, Fonterra, merged with Bonlac to take effective control of Australasian Food Holdings (SMH 2002) and by June 2005 moved to full ownership of Bonlac after failing in its bid to buy National Foods (SMH 2005).

pactices post-deregulation until 2003/04 (ABARE 2005:3) then levelled off in 2004/05 in response to improved terms of trade (ABARE 2006:3) Australian dairy producers, on average, have struggled to regain their pre-deregulation levels of efficiency, measured as total factor productivity. This decline is likely to be associated with cost and risk shifting from the retail and manufacturing sectors to producers post-deregulation, especially when trying to cope with drought conditions.

Employment in the sector has been considerably reduced. From a value-added perspective, a growing portion of Australian dairy manufacturing has been bought up by large multinationals since deregulation. For example, in WA, one of the two major dairy processors, PB Foods (Peters-Brownes) was taken over by Kiwi Co-operative Dairies (which later became Fonterra) just months after deregulation, the same company which has since bought the large Victorian Co-operative, Bonlac. National Foods, which bought WA's other major dairy processor, Masters, in 1993, was taken over by Philippines-based San Miguel in 2004, following an unsuccessful bid also by Fonterra (National Foods 2006). This rationalisation tends to challenge the argument that NCP will benefit Australia's manufacturing sector. Instead, in the case of dairy manufacturing, the major beneficiaries appear to be overseas corporate giants.

Revisiting the Industry Commission's assumptions[9]

Predicted price effects of removing statutory marketing arrangements – The IC estimated that removing SMAs would lead to a small boost to GDP of 0.03% but assumed that deregulation would remove what the IC termed a "30% price distortion" for market milk which would translate to a similar farmgate and retail price reduction.

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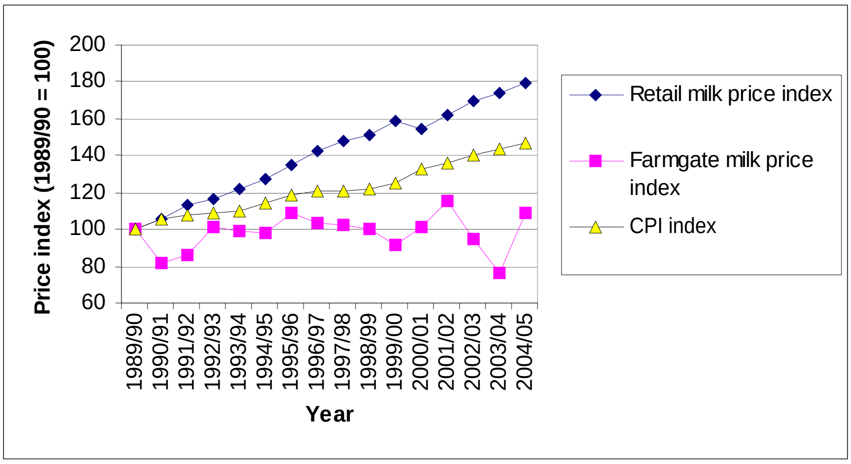
9 In 1994, COAG requested the Industry Commission to assess the growth and revenue benefits of Hilmer and related reforms and, in doing so, to

> undertake a review of previous studies which have investigated economic costs and benefits arising from microeconomic reform, outline the different scope and coverage of those studies compared with its current assessment, and, where feasible, reconcile the results of the current study with those from earlier studies.

(IC 1995: 3). In its 560 page report, the Industry Commission chose not to review its 1991 dairy predictions.

(IC 1991a, 1991b). Immediately following dairy deregulation, retail prices of market milk in supermarkets generally dropped, especially in the newly emerging homebrands, whilst prices for flavoured and specialty milk continued to rise. The ACCC was commissioned to monitor farmgate, retail and wholesale prices and profit margins from April to December 2000, just 6 months after dairy deregulation. (ACCC 2001: xv). Average domestic retail prices, having dropped temporarily, then began climbing again at a rate which exceeds CPI, as can be seen from Figure 1.

Figure 1: Indexed Retail and Farmgate Milk Prices 1989/90 to 2004/05



Sources: ABS, ABARE 2005c

The significance of this data is that, even as recently as October 2004, an NCC commissioned submission (Spencer 2004b: 6) still claimed that the consumer has been the 'big winner' from dairy deregulation.

Figure 1 also shows that retail prices have not directly reflected what has happened to average farmgate prices which, since deregulation, are now more closely linked to the international dairy market and, by association, to the value of the Australian dollar. Although the dismantling of State-based regulatory bodies that controlled the price and quantity of market milk *allowed* similar retail price reductions to that experienced by producers of market milk, there was nothing to *require* milk processors or retailers to pass on any reduced costs to consumers, which calls into question the main public interest argument of the IC and the NCC for supporting dairy deregulation.

Predicted 10% decline in output for manufacturing milk - As Figure 2 shows, output for manufacturing milk has declined since 2001/02. As this drop did not begin immediately after dairy deregulation, this could have been the combined result of farm departures, drought conditions, changes in the international dairy market or fluctuations in the value of the dollar. It won't be clear how much of the drop is climate related until rainfall in the major dairy regions returns to normal levels.

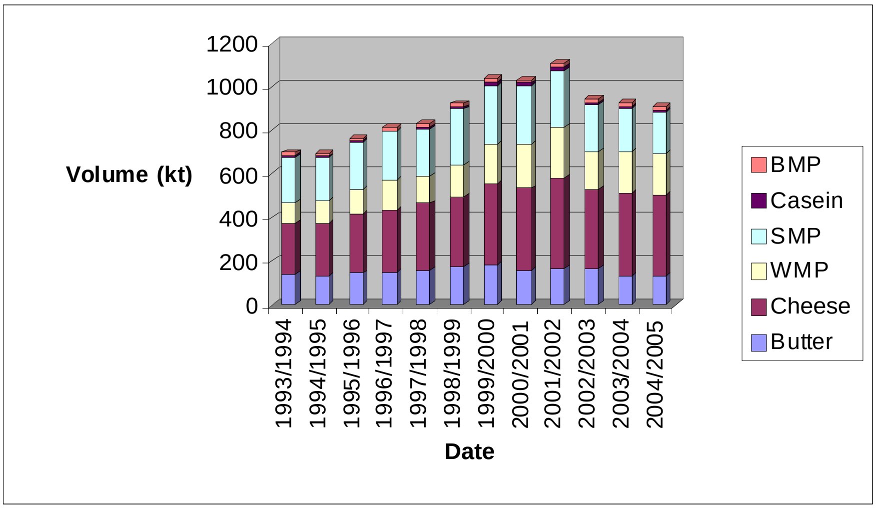
Ironically, the Hilmer Report promotes the potential of NCP for *enhancing* the value-adding of primary produce in Australia:

> The continuing exemption of some agricultural marketing arrangements (…) affects efficiency, and runs counter to efforts to increase our export income through further processing of primary products in Australia (Hilmer 1993: 15).

In their executive summary, Hilmer cites Prime Minister Paul Keating's sales pitch for '*free and open competition*' from his 1992 *One Nation* speech and adds:

> …Competition is also a positive force that assists economic growth and job creation. It has triggered initiative and discovery in fields ranging from the invention of the telephone to the opening of new retail stores and small manufacturing operations. In fact, it is these developments in smaller firms, prompted by the belief in these firms in their ability to compete, that are the main source of both new jobs and value-added exports (Hilmer 1993: xv).

Figure 2: Australian Dairy Manufacturing 1993/94 to 2004/05



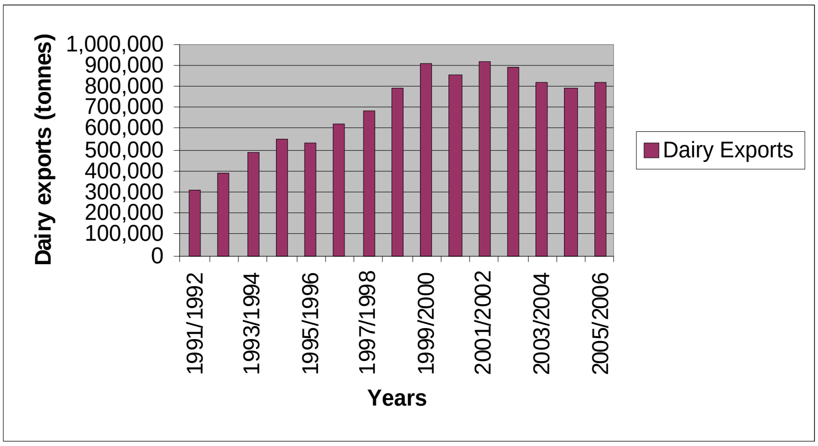
Sources: ABARE 2000-2002, 2003a, 2005b, 2005c

Predicted 80% decline in dairy exports - Not surprisingly, most of Australia's dairy exports are processed rather than fresh milk products. In value, *Australian Food Statistics* reports that in 1999/2000, 96.72 percent of the $2.291 billion worth of dairy exports was processed dairy products. In 2004/05, dairy exports were worth $2.486 billion, of which the proportion of processed dairy exports had increased to 97.75 percent (ABARE 2005b: 74).

Dairy exports as a proportion of total production volumes expanded from 44% in the early 1990s to almost 60% in 2002/03 and back to 50% in 2004/05 (Dairy Australia 2006: 11) and, as total production has reduced in recent years, some milk will have been redirected from manufacturing/export production to market milk. In dollar terms, rather than declining to 20% of the pre-deregulation export levels, as predicted by the IC (IC 1991b: xv), the most recently published export figures are similar to the value of exports prior to deregulation – $2,482 million in

2004/05 compared with $2,467 million in 1999/2000 (ABARE 2005b: 71).

Figure 3: Australian Dairy Export Volumes



Sources: Australian Dairy Corporation 1999-2002, Dairy Australia 2006, ABS

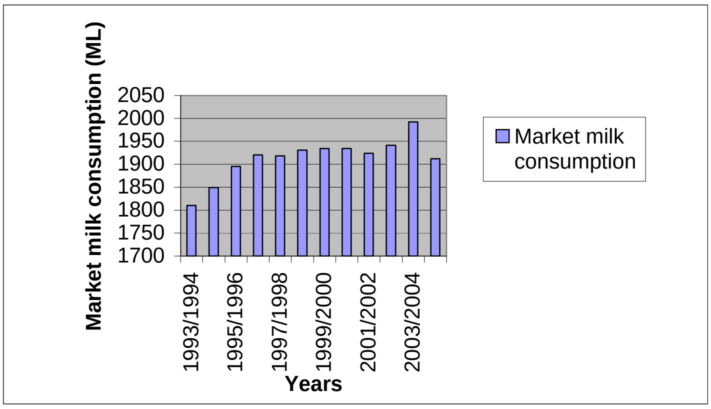
In volume terms, as Figure 3 above illustrates, we have seen a levelling rather than a dramatic fall in export volumes, with the 2005/06 export volumes of 820,075 tonnes roughly 10% down on the figures from 1999/00, having reached a peak of 917,392 in 2001/02 (Dairy Australia 2006a). The drought and the rising Australian dollar may also have influenced export volumes in recent years.

This outcome is significant, as the IC prediction of an 80% decline in dairy exports was clearly linked to the dual assumptions that deregulation would bring about a drop in farmgate prices for manufactured milk and that the State based statutory marketing arrangements for market milk constituted a substantial export subsidy. Other domestic or international trading conditions may well have affected the export volumes but it would have required an extraordinarily *positive* set of market circumstances to negate a prediction of such a large export loss. That prediction of a massive decline in exports appears to ignore the fact that the dairy regions likely to have been least impacted by a post-deregulation drop in market milk farmgate prices are those generally with highest percentage of exports.

Predicted 10% decline in dairy manufacturing employment - The latest available figures from *Australian Foods Statistics* do show dairy manufacturing employment just prior to deregulation at 17,000, peaking in 2002/03 at 19,050 and then dropping to 15,900 in 2004/05. This change represents a drop of 6.5% from pre-deregulation employment levels and a drop of 16.5% from the 2003/04 peak (ABARE 2000-2002, 2003a, 2005b, 2005c). There is insufficient data to determine what will happen to manufacturing employment after the drought.

Predicted minor expansion in the market milk sector employment - Demand for milk had been steadily growing with population in the years leading up to deregulation, levelling out in 1999/01, then rising in 2003/04 before dropping again in 2004/05, as can be seen from Figure 4.

Figure 4: Australian Market Milk Consumption 1993/94 to 2004/05

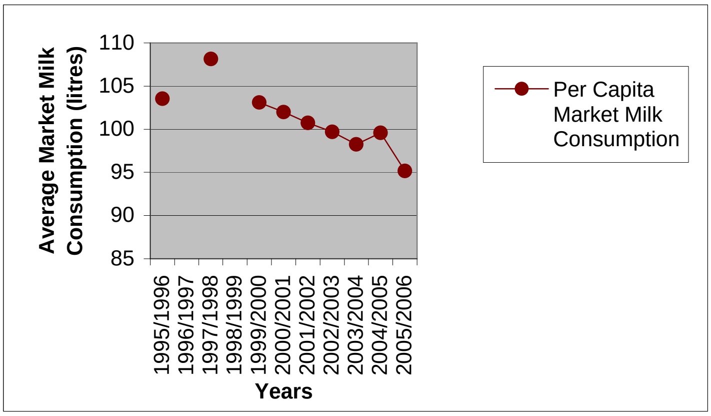


Sources:ABARE, 2000-2002, 2003a, 2005b, 2005c

The sudden decline in fresh milk consumption in 2004/05 is likely to be related to a combination of factors, such as an aging population, the availability of fresh milk, and promotion of alternatives such as UHT or soy, rather than simply a direct response to price.

However, as Figure 5 below indicates, *per capita* milk consumption has been trending down in the years following deregulation.

Figure 5: Australian per Capita Market Milk Consumption 1995/96 to 2005/06



Sources: ABARE, 2000-2002, 2003a, 2005b, 2005c, ABS

Note: No data available for milk consumption 1996/97 and 1998/99

In dollar terms, *Australian Food Statistics 2005* reports that average weekly household expenditure on dairy products rose slightly from $10.50 in 1998/99 to $11.26 in 2003/04, but expenditure on combined fresh milk and cream dropped from $5.89 to $5.64. This change would indicate that domestic fresh milk and cream consumption has dropped since deregulation (ABARE 2000-2002, 2003a, 2005b, 2005c).

There are no specific employment figures available for market milk but dairy farm employment has dropped at a much greater rate than for dairy manufacturing. Dairy farm employment is reported to have dropped from 33,736 in 1999/2000 to 21,550 in 2004/2005 – a drop of over 36%!

This does not count indirect regional employment losses. Entire federal elections have been lost over potential direct job losses in the native woodchipping industry of far less than this decline.

Predicted decline in the farm gate price of manufactured milk of between 5 and 9 percent, or 2 to 3 cents per litre - On average, the farmgate price for manufactured milk *rose* after deregulation, but the amount varies from region to region, as can be seen from the Table 1. The motives for the IC making the prediction of manufactured milk price drops are unclear because, as farmgate prices for manufactured milk prior to deregulation were already well below average world prices[10], it is unlikely that farmers in the large dairy cooperatives in States like Victoria would have agreed to deregulation and associated removal of market milk premiums if there was to be no subsequent increase in the price of manufactured milk. The rise in farmgate prices for manufactured milk, combined with the reduced wholesale prices offered by the supermarkets during the six months to December 2000, saw net profit margins for the dairy manufacturing sector over that monitoring period drop 12 -18% (ACCC 2004: 101), increasing manufacturing firms' vulnerability to overseas takeovers.

Table 1: Averages Prices of Manufactured Milk, Pre – and Post – Deregulation

Pre-deregulation				**Post Deregulation**	
Dairy Region	Market milk	MFG milk	AveragePrice	2003-4 prices	Av change
Far North QLD	54.9	21.9	36.7	29-31	-5.7 to –7.7
Central QLD	54.9	21.9	36.7	38-41	+1.3 to +4.3
S E QLD	54.9	21.9	36.7	29-31	-5.7 to –7.7
N Central & S NSW	47.7	21.8	32.6	29-34	-3.6 to +1.4
Victoria	42.7	22.2	22.2	25-30	+2.8 to +7.8
SA	44.6	22.2	28.0	25-30	-3.0 to +2.0
Tasmania	44.6	18.8	20.9	25-27	+4.1 to +6.1
WA	45.5	24.6	34.3	24-27	-7.3 to –10.3

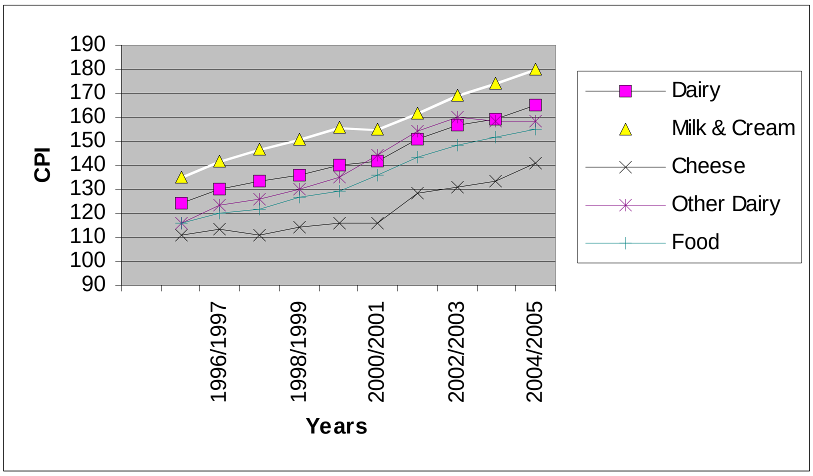
Source – Spencer (2004b: 20). Spencer cites the sources of this data as RidgePartners and Australian Dairy Farmers Ltd.

10 In 2000, the average European farmgate price for milk was 30.67c Euro (AUD$0.49). Even average New Zealand milk prices were higher than in Australia at 16.64c Euro (AUD 0.26) (LTO, 2000: 4).

Predicted fall in the prices of manufactured dairy products of around 12% as market support payments are reduced - There is no evidence of any sustained fall in the prices of manufactured dairy products post-deregulation. As can be seen from Figure 6, the prices for processed dairy foods such as cheese which had been rising at a rate less than CPI prior to deregulation, stabilised, then *rose* 12 percentage points from 2000/01 to 2001/02 (ABARE 2005c: 66).

Predicted decline in the farm gate price of market milk by more than one third, or around 12 to 15 cents per litre - As can be seen from Figure 1, this prediction would appear to be an underestimate. In some cases, the farmgate price fall for market milk was over 25c per litre – a drop of over 40%. As has also been seen, if the farm gate price for market milk declines, it may *allow* a similar retail price drop, but the blunt instrument of deregulation provides no guarantees that such a retail price drop will happen, or continue.

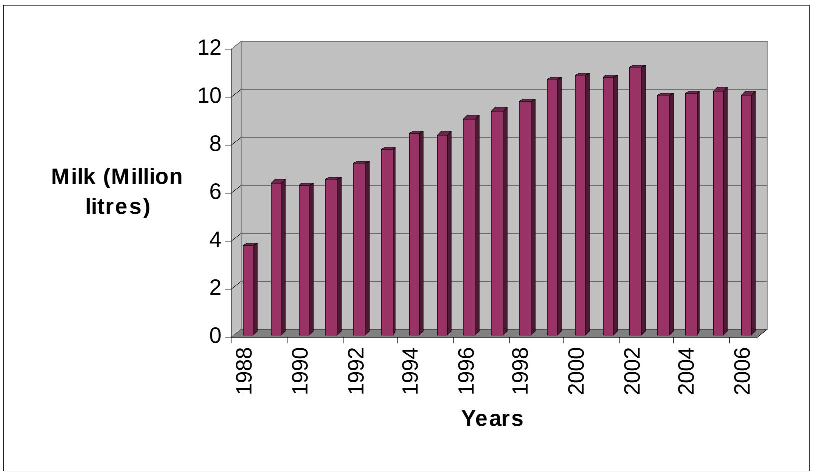
Figure 6: Dairy and Food CPI 1995/96 to 2004/05



Sources: ABARE 2001-2002, 2003a, 2005b, 2005c

Predicted likely decline in total milk output by around 5 percent - As can be seen from Figure 7, total milk production steadied after deregulation, peaked in 2002 and dropped again from 2003. Production in 2006 is around 10 % lower than 2003 levels and over 6% below pre-deregulation levels. Farm departures appear to have halted the levels of pre-deregulation production growth, but the recent drop in production is likely also to be related to drought.

Figure 7: Australian Milk Production 1988-2006



Sources: ABARE 2000-2002, 2003a, 2005b, 2005c

The IC's original dairy industry assumptions and modelling were generally open-ended and lacked qualification, but this paper is not claiming that all of the post-deregulation experience of the dairy industry can be attributed to NCP.[11] ABARE identify the combined effects of deregulation, drought, reduced water allocations and fluctuating world market prices as causing major restructuring in both dairy production and manufacturing since 2000 (ABARE 2005: 1). It is argued, however, that

11 Some would say that Australia s free-trade agreements, especially with New Zealand, made the removal of state-based statutory marketing arrangements inevitable, but the 1992 submission to the Hilmer Inquiry by the Australian Dairy Industry Council, which included the United Dairy Farmers of Victoria, opposed dairy deregulation on public interest grounds (ADIC 1992). Pressure from the powerful export-based Victorian dairy cooperatives to deregulate coincided with the phasing out of market support for domestically consumed manufacturing milk and the scrutiny put on the States via NCP after 1995 (Dairy Australia 2007: 8).

deregulation has made domestic market milk producers much more vulnerable to conditions which formerly would only have affected the dairy export sector, such as a rising dollar, and less able to survive domestic market conditions such as drought.

IC assumptions, such as the loss of most of Australia's dairy exports and the benefits for domestic dairy consumers once the premium prices for market milk were abolished, have yet to be proven. Such assumptions, especially relating to consumer outcomes, appear to have given little regard to the impact of the changes to the market bargaining powers of the production, corporate retail or manufacturing sectors once the statutory marketing arrangements were removed. Nor have they given due regard to the retail sector's potential to take more profits from the dairy sector at the expense of the dairy manufacturing, dairy production sectors and dairy consumers in a post-regulatory environment.

Consideration of Social Costs and Benefits of Dairy Market Deregulation

If the assumed consumer benefits of dairy market deregulation remain unproven, the case for looking more carefully at the associated social cost/benefit equation is strengthened. Relevant considerations include changes to farmgate prices, changes to dairy farm incomes, loss of family farm businesses, changes to levels of employment on dairy regions and loss of dairy processing capacity to overseas interests.

Changes to Farmgate Prices

The impact of farmgate prices is uneven across Australia, depending on the proportion of market milk that was being produced in each region. Victorian dairy farmers, on average, would be the major beneficiaries of any manufactured milk price rises, given their high percentage of manufactured milk. Average farmgate milk prices increased from their pre-deregulation levels (until 2003/04, at which point they suffered a drop in real terms, linked to changes in international market conditions) but mostly market milk producing regions like parts of Queensland and the South West of WA experienced the most dramatic average price drops.

As Figure 1 shows, average farmgate prices have not kept pace with inflation, nor the rising average retail price for milk, and appear to have become more volatile since deregulation.

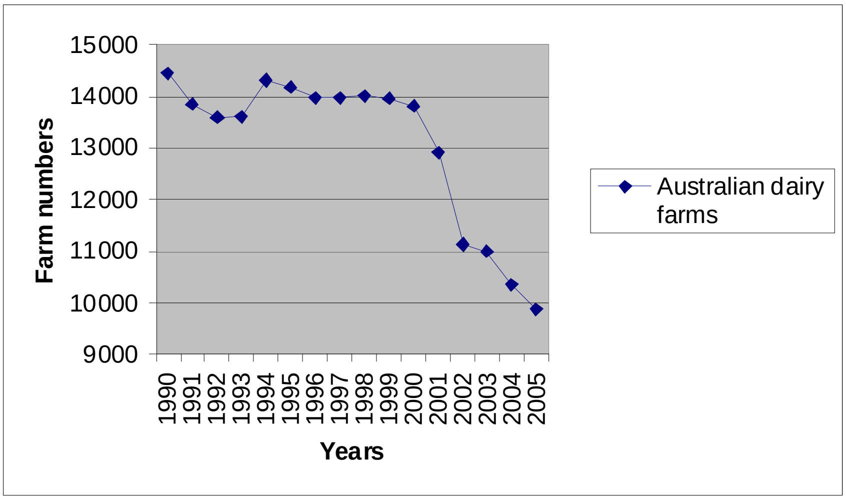
Changes to Dairy Farm Incomes and Profits

The ABARE report *Australian Dairy 05.1* (ABARE 2005: 1), prepared on behalf of Dairy Australia, shows that average dairy farm profits rose briefly and sharply for a period around the year 2000 and then dived even further into negative territory (to an average negative profit of $40,000 per year before returning to a zero profit level for 2004). Whilst ABARE attribute that profit dive to a combination of lower milk prices, reduced dairy cow numbers and milk yields, and reduced irrigation water availability due to drought, it is clear that deregulation has introduced a much greater level of profit volatility in the Australian dairy industry. The negotiated pre-deregulation farmgate price for market milk enabled dairy producers to adjust their production more readily to drought and other low production events – a means of evening out revenue streams to some extent.

Loss of Family Farm Businesses

Figure 8 shows that there had been a period of relative stability in dairy farm numbers from the late 1980s until 2000. The loss in dairy farm numbers has accelerated from 2000, the year of nationwide farmgate deregulation. The offer of Government adjustment packages clearly indicates that dairy farm departures were predicted, but it is questionable whether (even in periods of drought) such a high percentage of South Australian farm departures was expected or even that states like Victoria, which appeared to have the most support for farmgate deregulation, would lose almost one quarter of their dairy farm businesses over such a short period.[12]

Figure 8: Australian Dairy Farm Numbers 1990-2005



Source: ABS Year Books 1990-2005

ABS figures show that from 2000 to 2005 Australia lost around 3939 dairy farm businesses (average 28.5% reduction), of which WA lost 90 dairy farms (23.3%), Victoria lost 1934 (23.8%), NSW lost 475 (24.4%), Tasmania lost 190 (25.6%), SA lost 361 (46.9%) and Queensland lost 886 (48.1%).

12 There is more to come, especially if the drought breaks and land prices subsequently rise. Dairy Australia predicts that over the years from 2006-2009 the highest exit rates will be from Far North Queensland (40%) and Western Australia (34%) (Dairy Australia 2006: 25).

Changes to Levels of Employment/Unemployment in Dairy Regions

Declines in levels of employment in the dairy industry are reported in all dairy regions since 1996. Declines were highest in Western Dairy (from 19.4% to 14.6%), DIDCO (from 18.8% to 14.8%), Sub Tropical Dairy (from 14% to 11.4%) and DairyTas (from 29.5% to 27.1%) and smallest in GippsDairy, WestVic Dairy, and Murray Dairy (down around 1% respectively (Herreria *et al*, 2004: vii). The direct employment figure dropped from 60,000 jobs at farm and manufacturing level in 1999 to 37,450 in 2005 (a reduction of around 38%), consisting of 21,550 in dairy cattle farming and 15,900 in dairy processing (ABARE 2000-2002, 2003a, 2005b, 2005c).

Loss of Dairy Processors to Overseas Interests

Table 2 outlines the extent of overseas corporate takeover in the Australian milk processing sector since deregulation.

In addition to the above public interest considerations, it should be noted that dairy industry representatives have expressed concern that the extra pressure on farmers as a result of deregulation may require running larger herds, more intensive stocking, feeding and milk production (resulting in increased waste disposal problems), increased use of fertilisers, increased demands on limited water resources and less attention to animal welfare issues (Submission by Queensland Dairy Farmers Organisation and the Dairy Farmers Association of NSW to the Senate Select Committee Inquiry into the Socio-economic Consequences of the National Competition Policy *v*12: 2388). That prediction suggests that there may also be a case to investigate whether extra pressure on land and water resources of dairy farmers results from the reduction in their bargaining power.

Table 2 Changes to Major Dairy Processor Ownership 1999-2000 to 2006

Company	% Milk Intake 1999-2000	Ownership in 2000	Ownership in 2006
Murray Goulburn	29.0	Co-operative	Co-operative
Bonlac Foods	21.4	Co-operative	Fonterra (NZ)
Dairy Farmers Group	13.4	Co-operative	"Hybrid" Co-operative
Nestle Australia	5.8	Nestle Int'l (Switzerland)	Nestle Int'l (Switzerland)
National Dairies	5.4	Co-operative	San Miguel (Philippines)
Warrrnambool Cheese & Butter	4.8	Co-operative	Listed Company
Tatura Milk Industries	3.9	Co-operative	Co-operative
Parmalat Australia	3.9	Parmalat (Italy)	Parmalat (Italy)
Kraft Foods Ltd	2.7	Kraft (USA)	Kraft (USA)
Norco Co-operative	1.7	Co-operative	Co-operative
Bega Co-operative	1.6	Co-operative	Co-operative*
Peters & Brownes Foods Ltd	1.5	Australian **	Fonterra (NZ)
Lactos	0.9	Bongrain (France)	National Foods/San Miguel (Philippines)
Capel (Wesmilk)	0.6	Wesmilk (WA)	Challenge Dairy (WA)
Cadbury Schweppes	0.6	US/ International	US/ International

Sources: ACCC 2001, Company websites.

*Bega has retained its ownership as an Australian-owned cooperative, but has developed a close commercial relationship with Fonterra.
**PB Foods was a company rather than a cooperative business structure

Conclusions

The National Competition public interest test was meant to take into account:

- legislation and policies relating to ecologically sustainable development;
- social welfare and equity considerations, including community service obligations;

- economic and regional development, including employment and investment growth;
- the interests of consumers generally or of a class of consumers;
- the competitiveness of Australian businesses; and
- the efficient allocation of resources (Margetts 2001: 56)

On the basis of the above test, the NCC and the Federal Treasurer were wrong to simply override the majority of States' assessment of the public interest in retaining statutory marketing arrangements for market milk. There is, therefore, a very strong argument to require the States and the Commonwealth to revisit NCP outcomes, not only for statutory marketing arrangements but in a wide range of areas and systematically check whether the driving assumptions were accurate and the NCC's public interest rulings were justified. If not, it should be possible for the relevant levels of government to reintroduce appropriate regulatory safeguards against market failures in essential services and against corporate exploitation of their market powers. Now that the NCC has completed its legislative review functions, COAG members should also ensure that the same kinds of mistakes are not repeated with the successor to the NCC, the COAG Reform Council.

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