

SENATE ECONOMICS REFERENCES COMMITTEE

Questions on Notice

The impacts of supermarket price decisions on the dairy industry

Canberra, 10 March 2011

QoN No.	Hansard Page Reference	Senator	Witness/organisation	Question
1	E 73	Eggleston	Clover Hill Dairies	<p>CHAIR—Would you give us some details on New Zealand because we are interested in that comparison.</p> <p>Dr Moss—It is a large market that is predominantly manufacturing in orientation. I would estimate that 90 per cent of their milk is not consumed in New Zealand; it is exported. Because of the climate in New Zealand—it is a very Mediterranean style climate in that country characterised strongly by winter rainfall and spring rainfall—their production is extremely seasonal and highly linked to grass. At the moment they are definitely beneficiaries of a world export market. The flip side to that is that when world prices have been poor, such as during the global financial crisis, the New Zealand market was quite exposed and there was significant trouble within that market, as there was in the southern parts of our own manufacturing market.</p> <p>During that time, a number of our year-round suppliers were engaged in contracts that had been written well in advance. They were actually performing quite well in New South Wales and southern Queensland because they had decent long-term contract arrangements at that time that provided sustainable milk prices for those businesses to function and perform well. If we look at the South American market, which is a developing market, it has got quite a strong local base of consumption but it also has an evolving export base. We can supply, if required, on notice some more details on those markets to the committee.</p> <p>CHAIR—We would actually appreciate that because we want to be able to make comparisons. The Canadian story is very interesting. The New Zealand story is interesting.</p>
2	E 74 - 75	Heffernan	Clover Hill Dairies	<p>Senator HEFFERNAN—So just coming to terms with what has happened in Australia—which seems to be what Tesco, Sainsbury's and others have just done in the UK. These guys have come out here to teach Australia how to do what has happened and be paid a substantial amount more money in Australia than they got back there in England. Part of the commotion that caused, the inquiry found, was that</p>

				major supermarket chains were passing on excessive risks and unexpected costs to their suppliers. You could take this on notice if you like: could you provide any evidence of that here, given that the Tesco model is what is being tried in Australia under the cover of increasing export prices? Everyone says, 'It's A-OK, brother; the cows won't go to the saleyards.' The bill that they have proposed will pay a minimum price. But one of the problems they came across in England was that the suppliers copped the added costs of advertising, which were not in the contracts, and all the add-on bits were passed back to the suppliers. Do you have evidence of that here—that you get unexpected costs? Anyhow, take it on notice. And could I refer you to page 37 of today's briefing pack.
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Responses to questions:

Question 1.

Eggleston.

The following response has been provided following review of some internet based literature and my own knowledge. It should provide the committee with the information required with particular reference to New Zealand and Canadian milk markets. The committee is referred in particular to the review by Painter accessible on the link below for a review of the two markets and the impact of these markets on their local industries.

http://www.ifmaonline.org/pdf/journals/Vol4Ed1_Painter.pdf

Notes:

About 81% of Canadian dairy farms are located in Ontario and Quebec, 13.2% in the Western provinces and 5.5% in the Atlantic provinces. There are 452 dairy processing plants (including 272 federally-inspected) contributing to more than 22,730 jobs across Canada.

The Canadian dairy cattle population totals 1.4 million head. The typical Canadian dairy farm has 72 cows and produces an average of 5,579 hectolitres of milk per year.

The Canadian dairy sector operates under a supply management system based on planned domestic production, administered pricing and dairy product import controls.

Canada's dairy industry operates differently than that of most milk-producing countries.

In the early seventies, the dairy industry became the first in Canada to operate under a national supply management system. The egg and turkey industries soon followed suit with their own legislation in 1972 and 1973. Supply management of chicken was introduced in 1978.

Supply management regulates imports and domestic production to ensure that demand matches production and meets the average producer's costs. Each producer owns a contract, or "quota" that specifies the amount of milk that producer can deliver. Farmers can't ship milk without owning quota. By keeping supplies steady, prices—and therefore incomes—are stabilized, while processors and consumers are guaranteed a consistent supply of high quality dairy ingredients and products at reasonable prices.

Milk quota—and the privilege of producing milk that goes with it—was initially given to producers in the early 1970s. Today, farmers wanting to produce milk must buy or sell quota through a "quota exchange." At monthly quota exchanges, producers determine in advance how much quota they wish to sell or purchase at the prices they wish to receive or are willing to pay. The price of quota for that month is determined by matching quota for sale and quota in demand.

Imports and exports are an important part of the equation in effectively matching supply and demand. In the past, Canada restricted imports by using import quotas. However, in December 1993, Canada signed a World Trade Organization agreement under the GATT (General Agreement on Tariffs and Trade) that substantially changed the way in which imports are controlled, so that all import quotas were replaced by tariffs as of January 1, 1995. Initially high, the tariffs on imports will decline by a minimum of 15% over the six years the agreement is in effect.

The New Zealand dairy sector, like its overseas counterparts, is dominated by cooperatives, reflecting the perishable nature of milk, the sector's relative homogeneity and economies of scale in processing, market and distribution. The New Zealand dairy has no price regulation. It is a free market subject to world commodity prices. Painter's 2007 review highlights the differences between the two markets. It is highly dominated by the major farmer owned processor, Fonterra

New Zealand dairy farmers face additional exposure, compared with their overseas counterparts, from New Zealand's remoteness from its key export markets and high shipping costs. Cooperatives help to protect small producers from downstream market power and allow for better coordination of production, distribution, processing and marketing.

There are currently three core companies operating in New Zealand — Fonterra Cooperative Group Ltd, Westland Cooperative Dairy Company and Tatua Cooperative Dairy Company. The milk produced by nearly all New Zealand dairy

farmers is supplied to these cooperatives. Fonterra, owned by 11 680 farmers, collects 96 per cent of New Zealand's milk production. Westland has around 370 suppliers and produces around 3 per cent of New Zealand's milk supply, while Tatua's 124 suppliers provide most of the remaining 1 per cent.

Fonterra is the largest of New Zealand's cooperative manufacturing dairy company. As a leading multinational company, Fonterra is responsible for around 40 per cent of world crossborder dairy trade and a major player in the export of dairy ingredients such as milk powder and casein. Fonterra's international brands include Fernleaf and Anchor, and specialty products such as 'Anlene' (a high calcium, nonfat milk) and 'Anmum' (a milk powder especially formulated for pregnant women). Fonterra has a wide range of international marketing subsidiaries, joint ventures and other arrangements, which include collaboration in the United States (with Dairy Farmers of America), in the North and Latin Americas (with Nestlé) and in the United Kingdom and Europe (with Arla Foods).

In addition to these bigger export oriented companies, there are around seventy smaller companies operating in product or regional market niches in New Zealand. The Dairy Industry Restructuring Act 2001 requires Fonterra to supply up to 400 million litres of regulated milk, at a default milk price, to other independent milk processors to ensure that small processors are not forced out of the market. In 2005, Open Country Cheese, a private company, began operation and is currently expanding its direct milk supply, while another private company, Synlait, is developing a milk powder plant with local contract suppliers in the Canterbury region.

http://www.ifmaonline.org/pdf/journals/Vol4Ed1_Painter.pdf

Question 2.

Heffernan

I have no evidence that this is occurring in the current Australian liquid milk market

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Director SBScibus