



**Submission to the
Senate Standing Committee on Economics**

On

**Competition and pricing
in the Australian dairy industry**

27 OCTOBER 2009

THE VICTORIAN FARMERS FEDERATION

The Victorian Farmers Federation (VFF), Australia's largest state farmer organisation and the only recognised, consistent voice on issues affecting rural Victoria. The Victorian Farmer's Federation (VFF) welcomes the opportunity to provide some initial comments to the Senate Standing Committee on Economics on competition and pricing in the Australian dairy industry.

Victoria is home to 25 per cent of the nation's farms. They attract neither government export subsidies nor tariff support. Despite farming on only three per cent of Australia's available agricultural land, Victorian's produce 30 per cent of the nation's agricultural product. The VFF represents the interests of our State's dairy, livestock, grains, horticulture, flowers, chicken meat, pigs and egg producers.

The United Dairyfarmers of Victoria (UDV) is the dairy commodity section of the VFF and represents the dairy farmers of Victoria.

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Senate economics Committee
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Australia
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Dear Committee Secretary

The United Dairyfarmers of Victoria, the dairy commodity section of the Victorian Farmers' Federation, welcomes the opportunity to make a submission to the Senate Standing Committee on Economics on competition and pricing in the Australian dairy industry.

Victoria's dairy farmers make up about two thirds of the Australian dairy industry, which in 2007-08 produced around \$4.6 billion worth of milk at the farmgate. More than 50% of Australian milk production, is exported to some 100 countries, with the bulk of this export taking place from Victoria. In 2007-08, the value of dairy exports from Australia were worth close to \$3 billion. Dairy products are the biggest agricultural export from the Port of Melbourne.

Most dairy farmers in Victoria supply four main manufacturers whose product mix includes a substantial proportion of export products (Whole Milk powder WMP, Skim Milk Powder SMP, a range of specialty powders, butter and butteroil, cheese, whey and protein concentrates) plus smaller amounts of domestic market products with some also supplying milk to fresh milk processors. Most other processors present in Victoria concentrate on the domestic market (fresh milk, fresh and frozen dairy products, boutique cheese products).

As a result, prices for most dairy farmers in Victoria are heavily influenced by world trade prices for dairy products, which are distorted by the use of export subsidies and intervention buying in the US and EU, and various trade barriers in many dairy markets for Australian products. The Victorian dairy industry is therefore highly exposed to fluctuations in the world market.

Current situation for Victorian dairy farmers

In recent times, dairy farmers in Victoria, particularly those in northern Victoria, have suffered from prolonged and extremely dry conditions. They have had to use up reserves and increase debt to buy in water and feed, and to undertake programs to assist them to adapt and increase their flexibility to meet changed climate scenarios, such as building feed pads and buying machinery to mix and feed out rations to cows on the feed pads.

Farmgate milk prices dropped rapidly by some 30-40% in December 2008, exacerbating the already tough conditions most farmers were experiencing. The fall was triggered by the global financial crisis and caused a crisis in confidence amongst dairy farmers in Victoria, as most will be operating at below break even levels, with many receiving prices below their cost of production. The low prices have continued into the 2009-2010 season, and despite indicators that world prices have stabilised and are rising again, it is likely to be a long slow return to an environment where the majority of dairy farmers will be above break even. The rapid rise of the AUD has wiped out any significant increase in returns to Victorian dairy farmers, and until recently, high input costs (feed, fuel, fertiliser) had also adversely affected budgets and the ability to break even.

Dairy farmers in Victoria with direct contracts to milk processors have so far not been affected by the fall in export prices, but many are growing nervous about the future prices they will be offered as contracts expire during the next 12 months.

Dairy Australia's Situation and Outlook Report in October 2009 indicates that the number of dairy farmers considering leaving the industry within three years has increased to 16% compared to 3% in March 2009. The figure for the lower Murray Darling Basin is 43% considering their future by the end of 2009, with a significant proportion of these being in northern Victoria.

However the majority of dairy farmers remain positive about the industry (DA S&O Report October 2009) and their own future as part of it, as does the banking industry (personal communication). Global demand for dairy products is still strong and likely to remain so with rising world population, little or no new land available for agriculture and increasing concerns over global food security.

Milk pricing

There are some fifteen to twenty manufacturers and processors in Victoria ranging from Murray Goulburn, collecting close to a third of Australia's milk (3.4 billion litres in 2008/09 according to Dairy Australia's June 2009 Situation and Outlook Report) and processing about 60% of the milk produced in Victoria, down to boutique cheese manufacturers processing milk from a couple of farms.

Murray Goulburn's pricing sets the signals for pricing structures in Victoria, but those farmers with contracts to domestic fresh drinking milk processors expect to receive prices that will compensate them for producing an even level of milk all year round including through the high production cost periods from late summer through the late winter.

The UDV/VFF has concerns about the level market power held by the supermarket duopoly in the food sector, and how this feeds back into prices for dairy farmers. A Price Waterhouse Cooper study has found that the two major supermarket groups control some 78 per cent of the \$74billion grocery market. This duopoly can be used to influence sellers and can effectively lower market prices for their supplies.

However this duopoly effect is ameliorated to some degree by the level of export milk produced in Victoria. In most areas of Victoria, there is a choice of manufacturers to potentially supply, leading to significant competition for milk supply to meet export market throughput. There have been some changes in ownership of market milk processors in recent times but again in most areas, but not all, there is still a significant level of

competition for direct milk supply contracts with farmers. Dairy manufacturing companies also have contracts for fresh milk supply either to processors or supermarkets but the details of these are not freely available.

Feedback is also sought by the Senate Inquiry on whether the changes in market conditions and industry sector concentration warrant a review of aspects of the Trade Practices Act 1974. The ACCC investigated this issue in 2008 but could not confirm breaches in the Act at the time. The VFF endorses the comments in the Australian Dairy Farmers Ltd submission suggesting that a regular review of such issues is warranted by an appropriately authorised body such as the ACCC.

Impacts of milk pricing

Prolonged low prices in the Victorian dairy industry coupled with ongoing dry conditions mean forecast total milk production is likely to be lower for 2009-2010, partly through lowered production on farms as herds are reduced to cut feed costs or per cow production falls with reduced feeding rates, and partly through exits from the industry.

Continued falls in production will damage the capacity and efficiency of the industry and damage both regional economies through flow on effects to other regional businesses, and the Victorian economy, as the dairy supply chain is a major industry and employer in the state.

If significant capacity is lost, the industry will have difficulty rebounding when prices recover.

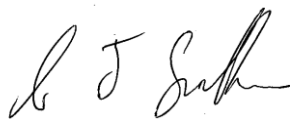
Mechanisms to improve returns

The VFF strongly supports any actions taken by the Government that will assist Victorian dairy farmers to return to world competitiveness and build reserves that will enhance their ability to increase their resilience and adaptability to face future climatic and market challenges. These could include -

- A CPRS structure that will not impact on Australian dairy competitiveness in global trade
- Water efficiencies on farm and in systems, with planned rather than random federal water buyback programs
- Lowering of trade barriers
- Infrastructure to assist competitiveness
- Outcome-focused science-based regulatory requirements

Thank you for the opportunity to provide input to this inquiry and we look forward to an outcome that will contribute to the viability of dairy farmers and the dairy industry. If there are any queries or clarifications sought, please contact the UDV/VFF.

Yours sincerely



Chris Griffin
President UDV/VFF