

DairyTas Board Submission

November 6th 2009

Senate Economics Committee

This inquiry will investigate the current circumstances of the varying prices being paid to dairy farmers in different Australian states

This DairyTas submission focuses on the negative impacts on the Tasmanian Dairy Industry from a combination of low milk prices and limitations on the peak season milk processing capacity. Together these factors are conspiring to potentially drive otherwise viable dairy farms out of the industry if they are allowed to continue for any reasonable period of time.

In many respects both factors are the result of the global financial crisis but have left Tasmania dairy farmers carrying a burden which now threatens their future.

DairyTas is a service provider to the Tasmanian Dairy Industry funded through farmer levy payments. It is managed by an Executive Officer under the direction of the farmer based Board. A brief outline of the Board's role is attached to the submission.

(a) The economic effect on the dairy industry of announced reductions in prices to be paid to producers by milk processors;

Tasmanian dairy farmers are currently being paid below the cost of production for their milk. This is not a sustainable situation and if it continues beyond 2009/10 it will have a severe impact on future milk supply, the numbers of farmers in the industry and the viability of the Tasmanian and national dairy industry.

It would appear that the deregulation of the dairy market prices around Australia has meant that milk prices are more likely to vary in different regions depending on the market and supply conditions at the time.

In the six months from March to September 2009 the Dairy Australia farmer survey through the Dairy Situation and Outlook Report showed that in Tasmania the % of farmers considering leaving the industry over the next 3 years has risen from 0% to 18%.

The first chart attached shows milk production and average milk prices for the past 20 years. This shows the significant increase in milk production during that time and the large fluctuation in average annual milk prices paid to Tasmanian dairy farmers. The 2009/10 milk price is forecast by DairyTas to finish the season at \$4.15/kg MS which

requires further step ups in price to be achieved with the base price now being closer to \$3.80 kgs MS. This is based on the expectation of a continued rise in international markets for dairy product. For many farmers this price still represents a position below the cost of production.

Compared to last year (2008/09) Tasmanian milk production this year is estimated to be 50ML down which will mean a loss in farm income of some \$15M or an average of \$40,000 per farm. Added to this is the loss from the lower milk price which compared to last year would add a further \$5M.

Figures from the Tasmanian Institute of Agricultural Research (TIAR) and Dairy Australia on dairy farm costs of production show they currently average around 34 cents per litre while most farmer milk prices are below 30 cpl. Farmers supplying more milk out of the main spring season face higher costs of production and they should be looking more at a breakeven price of 38 or 39 cpl (this equates to a price more like \$5.10 kg MS). Latest figures show that average production costs equate to just under \$4.50 kg MS but this can vary significantly on a farm to farm basis depending on feed inputs and debt levels.

The second chart attached shows milk price and operating cost movements highlighting where we have now come to with price being below the cost of production in Tasmania.

The high prices of 2007/08 and the first half of 2008/09 have meant that many farmers should have gained some reserves through farm operating surpluses to assist in coping with the downturn. What they would not have factored in was how quickly these reserves would be needed.

The speed and severity of the downturn from the Global Financial Crisis has caught everyone by surprise including farmers, processors, banks and governments. So far across the dairy industry it appears that the farmers have had to bear the costs of this downturn. The reliance on export markets has caused greater pain for dairy farmers. Our main Tasmanian milk processors Fonterra, National Foods and Cadbury have had the benefit of a solid domestic market yet have required farmers to bear the brunt.

This situation emphasises the poor bargaining position that farmers have with limited ability to maintain a base price payment and contracts able to be changed quickly with no consideration of farmer investments and plans. Dairy farmers tend to be in the industry for the longer term and cannot turn the tap on and off in their cost structures and farm operations. The largest dairy company, Fonterra cannot provide farmers with an indicative or estimated price for the season. This makes it difficult for farmers to budget in the short term. But having said that this situation is something that farmers have learnt to manage and accept.

Tasmanian dairy operations are larger than the national average with a herd size of over 300 cows (compared to 220). The 2009 TIAR Benchmarking data showed an average

herd of 466 cows and dairy assets of \$4.8M per farm. Since 1999/2000 this asset value has risen from \$1.3M, or 3.5 times.

The expansion and growth of Tasmanian dairy farms and the industry generally has also meant that Tasmanian dairy farmers have higher debt levels. This means their businesses are more vulnerable to periods of low milk price. Milk companies like Fonterra have supported this growth but when the international markets turned down they have expected farmers to cope with average milk price reductions compared to 2007/08 of some 40%.

This is clearly an unsustainable situation and unless positive action is achieved over the next 6 months through a higher milk price then the industry faces a serious contraction in Tasmania. This is in no ones interest and milk companies must act to support their dairy farmer through the international downturn and with government support if necessary.

(b) The impact of the concentration of ownership of milk processing facilities on milk market (and manufacturing milk) conditions in the dairy industry;

In addition to this milk price disaster the main Tasmanian processor, Fonterra has acted to constrain milk supply from new suppliers by postponing its planned factory capacity upgrade. This has meant that dairy farmers supplying other processors are not able to switch supply if they need or wish to do so. Hence the market is captive.

This in turn has created market conditions that are conspiring against Tasmanian dairy farmers. If Fonterra are not able to change this policy then all efforts should be made to encourage other players like Murray Goulburn or a new player altogether to enter the industry in Tasmania to purchase and process milk.

Milk Processing Capacity

The Tasmanian dairy industry has been driven by the international market conditions for dairy products and international commodity price movements. Farmers have been forced to adjust to the variability of returns from these markets. However the consolidation of market share with Fonterra and National Foods nationally and in Tasmania has meant that farmers have less option in where they supply their milk. Especially important in the recent 12 months has been the impact of the National Foods takeover of Lactos.

Fonterra has been the benchmark for milk price in Tasmania with Cadbury and National Foods driving their prices off this base despite the fact that they are in quite different markets.

As all milk companies are in the business of purchasing milk from farmers all parts of the industry are driven by both the fresh milk and manufacturing milk markets and prices, and are subject to regional supply conditions and markets. For example National Foods and Cadbury can reduce the price paid for milk in Tasmania as Fonterra's price is lower and so farmers have limited choice to where they can supply their milk.

Up until 2009 Fonterra has always been able and prepared to take additional milk supply and have encouraged farmers to increase production. This is now limited to existing farmer suppliers meaning that others do not have an option move to Fonterra and new farms cannot commence production. This has meant a captive market situation for farmers in Tasmania. This situation has arisen from Fonterra's decision to defer capital investment to incrementally expand production capacity at Wynyard. We are hopeful this investment will take place in 2010 allowing the industry to return to an unconstrained market place for milk supply.

Added to this is the fact that Fonterra has always purchased peak season milk from the other companies who want a flatter seasonal milk curve.

Fonterra's position with regard to future capacity will put a lid on milk production and discourage new investment if it does not change in the current year. Fonterra has indicated they want more milk outside the peak season but do not want to pay the higher price to make it economic for dairy farmers to change calving away from the natural advantages of spring production.

Milk production in Tasmania has grown by over 20% in the last 5 years to reach 708ML in 2008/09. This is nearly 8% of national production. Nationally at the same time milk production has fallen by 9%. We expect 2009/10 will see a 50 to 60 ML loss due to a combination of milk price and seasonal conditions. Further constraints imposed by Fonterra will further limit future production as new entrants are discouraged and we need that growth to offset the other trend of farmers leaving the industry (for various reasons and a longer term issue).

Fonterra have not yet confirmed that they will be going ahead with this capacity investment for 2010. Though there is an expectation that they will. One view might be that Fonterra are more interested to drive their milk production and growth from NZ rather than spend additional funds on manufacturing capacity in Tasmania where a smaller scale exists. There appears to be a reluctance to invest in milk factory stainless steel for an apparently limited peak season. Plus they can transport milk or product concentrates to the mainland during the peak season window.

Market indicators have shown that demand for dairy products is growing around the world on a per capita basis so we would expect to be able to grow with this demand at least.

Farm milk production in Tasmania can vary significantly with seasonal conditions which means the peak season production could be well under or over budget. This example is evident in 2009 with a spring peak milk level likely to be some 10-12% below last year.

Murray Goulburn has indicated interest to develop their business further in Tasmania with a processing facility but have not made any announcements. Currently they operate the Edith Creek UHT plant (which could expand) and they have also been in discussions with the Northeast Water Development project. MG operations in Tasmania will be good for farmers by offering options for additional growth and alternatives for farmers to switch companies. Some encouragement by the State and Commonwealth governments in this regard would be good for Tasmania especially in the light of Fonterra's uncertainty about future processing capacity.

Dairy Industry Strategic Plan 2006-2010

The situation outlined has implications for the future Tasmania Dairy Industry Strategic Plan which is being reviewed in 2010. To date this 5 year plan has been relatively successful in achieving its objectives but events in 2009 have put a dampener on this. The industry has moved away from being a vibrant and positive industry in a short period of time. DairyTas believes that a healthy and growing Tasmanian dairy industry is vital to the local economy and regional communities.

The current Strategic Plan is underpinned by a growth agenda for the Tasmanian industry. The table below highlights this recent growth which has been unmatched across Australia.

	Milk Production			
	MLs			
	Target	Actual	Growth T	Growth A
2005	600	600	0	0
2006	610	622	1.67%	3.67%
2007	640	644	4.92%	3.54%
2008	680	662	6.25%	2.80%
2009	720	708	5.88%	6.95%
2010	750		4.17%	

Tasmania can produce milk at a very competitive cost of production and has the potential to grow further as water resources are secured and new farms convert to dairy. But this production potential requires a milk processor that has the capacity and interest to invest in Tasmania. The ownership and decision making of all of the main milk processors is outside Tasmania and overseas meaning that local interests will not be part of this decision making.

Future Implications

The low milk price and factory investment uncertainty outlined above are having a severe negative impact on the businesses and livelihoods of Tasmanian dairy farmers and as a result our industry is coming under severe threat.

Tasmanian dairy farmers are now increasingly at the mercy of the large multinational enterprises in manufacturing and retailing who are driven not by local support but by shareholder profits. Whilst this remains the case farmer returns will fluctuate and local interests may not be looked after. A similar situation exists in the vegetable processing industry with Simplot and McCains more than happy to import vegetables from cheaper markets.

The Australia dairy industry is receiving little benefit from the international market place where protectionism remains entrenched and access to markets is limited. The current Government's plans around a carbon pollution reduction scheme that adds costs to our farmers will place us at more of a disadvantage unless other countries move the same way.

The Australian Government needs to do more to support its food industry and locally grown and supplied produce. The free market will not do it for Tasmania.

(c) The impact of the consolidation of the ownership of the market or drinking milk sector with the manufacturing milk sector on milk market conditions in the dairy industry;

See above for comments relevant to this issue.

(d) The impact of the concentration of supermarket supply contracts on milk market conditions;

The main overall observation to make is that the dominance of major retailers has a negative impact on farmers as they use their market power to drive down the returns to suppliers and farmers.

(e) whether aspects of the Trade Practices Act 1974 are in need of review having regard to market conditions and industry sector concentration in this industry;

(f) Any other related matters.

What is DairyTas?

DairyTas is the Tasmanian service delivery arm of Dairy Australia, investing farmer levies and other funds to support the Tasmanian Dairy Industry.

DairyTas' main aim is to identify, prioritise, promote, facilitate and leverage opportunities for research, development and extension activities in the Tasmanian dairy industry which will assist dairy farmers to manage change.

Further to this the DairyTas Board seeks to encourage the development of a sustainable, vigorous and dynamic dairy industry in Tasmania that offers economic and social rewards to dairy farmers and those in the wider community.

The Board's roles are to:

- encourage ideas and adopt a rigorous process for identifying and prioritising the needs of grass roots farmers
- identify underlying problems which such needs reflect
- resource projects, co-ordinate funding and commission projects to address these needs
- monitor and evaluate project performance to ensure there are genuine outcomes
- act as a broker for innovative projects
- attract funding to leverage the pool of available resources
- provide local input to national forums
- provide feedback to farmers, industry service providers, Dairy Australia and other stakeholders

DairyTas adopts a wider role in the Tasmanian dairy industry to add value to its programs by co-operating with other stakeholders such as the Tasmanian Institute of Agricultural Research (TIAR) Dairy Centre, NRM Regional Organisations, State Government, industry consultants and agribusiness and the Tasmanian Farmers and Graziers Association Dairy Council (TFGA).

The Board's main roles relate to research, development, extension and skills development. Marketing and political activities are not part of its charter.

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