

# **Industry plans and dairy support policies in Australia**

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by

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## **Introduction**

From a policy perspective there were two broad phases to dairy industry development in Australia. They could be described as the industry support period and the policy reform period. An overview of the policy instruments and the changes that were made in recent times could be useful when considering dairy development strategies. The aim of this note is twofold:

- give a brief overview of the major industry support policies that shaped industry development in recent times;
- outline policy reforms that were introduced to encourage the transition to a globally cost competitive industry with a focus on export sales.

## **Background to industry support policies**

The policy principles of price equalisation and underwriting of guaranteed returns was a feature of Australian dairy industry support until the mid 1980s. At different times some variations were made to the way the schemes operated. But these principles were the central features of policy arrangements.

One of the more significant changes was made in the mid 1970s when the Federal Government established a new set of marketing arrangements for manufacturing milk. They remained in place until the mid 1980s. It involved the pooling of market returns for five prescribed products:

- butter;
- cheddar and related types of cheese;
- casein; and
- two types of milk powder – whole milk powder and skim milk powder.

A separate pooled return operated for each product category. In each case a levy was imposed on domestic sales which raised the price paid by consumers. Levy funds were combined with export returns and manufacturers received an average ‘pooled’ return based on the amount they produced. It effectively meant exports returns were subsidised by an implicit tax on domestic consumers.

A government authority, the Australian Dairy Corporation, was established to manage the pooling arrangements. The authority had the power to issued export certificates which specified export values for particular markets and/or products. The exporter was required to remit the full value of the certificate for inclusion in the relevant pool of returns.

These pooling arrangements were a continuation of the ‘equalisation’ concept that was established in the early 1920s. But it was a highly distorted set of pricing arrangements. Market signals on the relative profitability of different products were difficult to assess. This affected the way dairy manufacturers approached their product marketing.

The pooling of export returns removed the incentive for market development. There was very little incentive for individual companies to increase plant efficiency, increase returns by altering their product mix, invest in export marketing efforts and adopt innovations. All participants in the product pool received the same average return.

In the mid 1980s the Federal Government decided the support policies for manufacturing milk had to be fundamentally reformed. An industry development plan was established – it became known as the *Kerin Plan*. The aim was to remedy deficiencies in the existing support arrangements. It led to changes in the fluid milk market support arrangements operated by States Governments.

When this plan was implemented a national market for dairy products did not exist. Government regulations had created an artificial separation of the market between fluid milk sales and milk used for manufactured dairy products. State Government regulations had established six separate markets for fluid milk which controls on interstate trade.

Milk production was highly seasonal and there was a perceived need to ensure adequate supplies of drinking milk throughout the year. State Governments used pricing controls to ensure farmers had the incentive to meet the demand for off-season milk. Each State had a Statutory Marketing Authority with monopoly rights on milk marketing. Prices were regulated at each stage of the marketing chain.

Voluntary restrictions on interstate trade in drinking milk were established to prevent companies from undermining the price controls. There was no commonality in fluid milk pricing between the States. Pricing decisions were based on costs of production and what was considered to be a ‘fair’ price for dairy farmers. Prices were set at levels well above the export parity price for manufacturing milk.

Price support for manufacturing milk was based on the pooling arrangements introduced in the mid 1970s. Pooling had two effects on market returns. It averaged export returns for each product across all manufacturers which removed the link to world prices for individual products. It also distributed the revenue raised from the regulated domestic price premiums across all output. The net effect was to raise the price of manufacturing milk above export parity.

### ***The dairy industry plan of the mid 1980s***

The industry plan of the mid 1980s involved substantial changes to the marketing arrangements for manufacturing milk. The pooling of export returns was abolished. From that point manufacturers received the prevailing world price for their exports of each product. They also received a *Market Support Payment* (MSP) on their exports.

The MSP was paid at a uniform rate on all exports. It was funded by a farm gate levy on all milk production. Regulation of domestic prices continued although the level of price support was reduced to the ‘fair trading’ prices of imports from New Zealand.

The government underwriting commitment on export returns was adjusted to reflect 85% of the long term average price of each product. Under these arrangements dairy product manufacturers had to respond to changes in world prices. The change initiated a process of post-farm gate industry rationalization. Smaller farmer co-operatives merged to gain economies of scale in processing and marketing.

The objective of the industry plan was to improve the global competitiveness of the industry and gradually reduce the level of support. The phased reduction in support gave dairy farmers time to adjust to the impact on farm incomes. The plan was successfully implemented and in the early 1990s was superseded by a new industry development initiative that became known as the *Crean Plan*.

In this plan Government underwriting of export returns was abolished. A maximum level of support was established based on export parity prices. It specified annual reductions in support to a level of 10% of the average export price by the year 2000. In the mid 1990s the support mechanisms were re-designed in response to a WTO interpretation that the plan involved an export subsidy scheme.

In 1995 the industry plan was revised to include the *Domestic Market Support Scheme* (DMS). The new marketing arrangements provided the same level of support but the link to export sales was removed. A new system of separate levies on domestic sales of milk and manufactured dairy products was introduced.

The combined levy revenue was used to fund a DMS payment to manufacturing milk producers. Farmers received a per litre payment based on their output of manufacturing milk. A further change in the industry plan was an end to the voluntary restrictions on the pricing of interstate sales of drinking milk.

The revised industry plan triggered changes in the drinking milk marketing arrangements operated by the State Governments. Production quotas had long used to restrict access to the fluid milk markets. Three states abolished quotas and replaced them with pooling arrangements. Farmers received a fluid milk price premium for a fixed proportion of their total output. Other States maintained their fluid milk quotas until July 2000.

A number of other changes were made to the fluid milk support arrangements by State Governments. In general it involved deregulating the post farm gate marketing controls. Pricing controls on wholesalers, vendors and retailers were removed. Restrictions on trading zones for individual processors and vendors were eliminated.

The objective of these changes was to increase competition and improve the efficiency of the milk distribution system. Marketing margins on fresh milk sales were deregulated. Processors and retailers set prices according to changes in cost structures and product marketing initiatives. There was a considerable amount of industry adjustment during the life of these industry plans and a large number of farmers left the industry.

## ***The industry development plan of the year 2000***

In the late 1990s there were a number of pressures for a new industry development plan. Federal legislation for the manufacturing milk price support scheme was scheduled to terminate in June 2000. This event would have implications for maintaining the State based fluid milk price support arrangements.

Strong growth in manufacturing milk supplies and import competition had diluted the farm gate value of the market support payments. Revenue raised by the support measures was increasingly spread over a larger volume of manufacturing milk production. There was also the risk of a WTO challenge to the legality of the scheme

Import protection had been gradually reduced since the industry development plan of the mid 1980s was introduced. The support arrangements had created an incentive for other countries to export dairy products to Australia. Domestic prices were above export parity and imports from New Zealand were growing. By the late 1990s New Zealand exporters supplied more than 10% of the cheese market.

The Victorian dairy industry was the major milk producer in Australia and dominated by farmer co-operatives. Competitive pressures on performance were an ever present incentive to consider the commercial gains from selling milk interstate. As the value of the support arrangements declined producer support for an end to the interstate trading restrictions strengthened in Victoria.

There were growing commercial pressure for unrestricted interstate milk sales. This came from the dairy manufacturing co-operatives focused on export sales and the food retailing sector. Commercial arrangements by the fresh milk processors were moving towards a national sourcing and distribution system for home brand milk contracts.

In the late 1990s all dairy support policies were subjected to a regulatory review process. One State Government accepted a recommendation to terminate farm gate price controls. This was to occur on 1 July 2000. After considerable discussion the industry collectively decided to support full deregulation of the dairy market in conjunction with adjustment assistance to manage the impact on the farm sector.

A new industry plan was developed that involved simultaneously ending all State based support schemes for fluid milk when the manufacturing milk price support scheme was ended on 1 July 2000. There was no transition period – the change happen over-night.

The Federal Government implemented a A\$1.78 billion industry restructuring package as part of the industry plan to fully deregulate. The package had two main components:

- a *Dairy Structural Adjustment Program* (DSAP) of transitional assistance for all dairy farmers.
- a voluntary *Dairy Exit Program* (DEP) to assist farmers in financial distress.

The adjustment assistance was funded by a levy imposed on domestic sales of liquid milk. A consumer tax of 11cents/litre remained in place for several years until the cost of the assistance was fully recovered. The levy was set at a rate to achieve an initial reduction in the retail price of milk and to limit the package repayment period. It was equivalent to a two-step phasing out of the farm gate pricing regulations.

The decision to deregulate caused some further substantial structural changes in the industry. A large number of dairy farmers left the industry. The remaining producers made substantial changes to their farming operations to off-set a decline in net farm income. The on-farm adjustments resulted in milk output per farm increasing by 6% in the first year of deregulation and almost 14% in the second year:

- substantial structural changes have occurred over the life of the industry plans since the mid 1980s;
- these changes have contributed to improvements in the scale and productivity of Australian dairy farms;
- the industry has become a globally cost competitive industry with a strong focus on exports.

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