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EXTRACTS AND PARTIAL UPDATE
OF THE REPORT:

Supply Management in the Dairy Sector, Still an Appropriate Regulation Method

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The deregulation of the Australian dairy industry is too recent to be able to draw definitive conclusions.

On July 1, 2000, Australia began deregulating its dairy industry after several decades of government intervention, particularly in the fluid milk sector. Before July 2000, dairy production was divided into two types of milk – fluid milk and industrial milk. The method of regulating the fluid milk sector was primarily the responsibility of each of the country's six States. Fluid milk production was regulated both in relation to authorized volumes and farmgate prices. Indeed, each State's authorities set a substantially higher farmgate price for fluid milk than for deliveries intended for the industrial milk market. On average, the price of fluid milk was about 20 Australian cents a litre higher than the price of industrial milk (Edwards 2003, p. 77), which was closely dependent on the international export price of dairy products. The average farmgate price of milk thus varied from one State to another, depending on the relative importance of the fluid milk sector in each State. Thus, the average price of milk ranged from 25 Australian cents per litre in Tasmania to 40 cents per litre in Queensland in 1998/1999 (Whetton 2000, p. 2).

The means used to manage access to the fluid milk market varied between States. The States of Victoria, Tasmania and South Australia had opted for "equitable" marketing (Edwards 2003, p. 78). This system was equitable in that it allowed all dairy producers in these three States to benefit from the premium on fluid milk. Each producer was thus paid in proportion to the total deliveries to each of the two markets in the State concerned. Thus, in the State of Victoria, each producer was paid as if 6% of his deliveries went to the fluid milk market and 94% went to industrial milk. It should be noted that the fluid milk share of the total production of these States was the lowest in all of Australia, namely 6%, 8% and 26% respectively for Victoria, Tasmania and South Australia, versus 43% to 46% for the other three States (Table 1.1).

The States of Queensland and Western Australia used individual fluid milk production quotas linked to the land. New South Wales has used tradable quotas since the early 1990s. In both cases, producers had to hold fluid milk quotas to be entitled to the higher farmgate price paid by this market.

TABLE 1.1
Total milk production and breakdown by type of milk and State Australia, 1999-2000 (million tons)

	Fluid milk	Industrial milk	Total production	Share of fluid milk
New South Wales	596	799	1,395	43%
Victoria	440	6,430	6,870	6%
Queensland	383	465	848	45%
South Australia	185	528	713	26%
West Australia	190	222	412	46%
Tasmania	48	561	609	8%
Total Australia	1,842	8,911	10,847	18%

Source: Australian Dairy Corporation, 2001, cited by Edwards 2003, p. 78.

While it ranged from 1.0% to 2.4% in previous years, the rate of decrease in the number of dairy farms jumped to 8.2%, 6.7%, 3.6%, 9.8% and 3.7%, in that order, in the years following deregulation.

The deregulation of the Australian dairy industry is too recent to be able to draw definitive conclusions. Table 1.2 nonetheless shows the recent trend of farmgate milk prices in each State and for the country as a whole. We can see that for all of Australia, the average farmgate price increased by 11.6% after deregulation in 2000/2001 in relation to the previous year's weighted average price. However, rather than concluding that deregulation produced an immediate benefit, it must be noted that deregulation occurred at a relatively favourable time in the price trend of dairy products on the international market. Moreover, the average farmgate price for 2002/2003 declined, like the world price, showing the sensitivity of the farmgate price in Australia to international market conditions. Two States took advantage of this upturn in export prices with a higher average farmgate price in 2000/2001 than in 1999/2000; these were the States of Victoria and Tasmania, where fluid milk accounted for the lowest proportion of total deliveries and which, therefore, were already the States most dependent on international market price trends. For the three States in the opposite situation, New South Wales, Queensland and West Australia, the average farmgate price in 2000/2001, after deregulation, was lower than the 1999/2000 weighted average price by 13%, 20% and 29% respectively. Each producer's situation could have varied according to the exact ratio of his individual fluid milk quota to his total deliveries. Moreover, since there is neither collective negotiation of farmgate milk prices nor government control over their level in a context of deregulation, the price paid can vary between processors, especially since premiums may be paid on fluid milk deliveries to guarantee a year-round supply (Whetton 2000, p. 6). The results presented are thus average values.

TABLE 1.2
Farmgate price trends in Australia, by State 1997/1998 to 2004/2005 (Australian cents per litre)

	NSW	VIC	QLD	SA	WA	TAS	AUST
INDUSTRIAL MILK							
1997/98	25.1	22.7	24.0	21.8	25.6	20.4	22.9
1998/99	25.3	23.0	23.7	23.1	24.7	21.8	23.2
1999/00	21.8	20.7	21.9	22.2	24.6	18.9	20.9
FLUID MILK							
1997/98	49.6	43.1	55.3	43.8	45.1	45.0	47.9
1998/99	47.0	43.4	55.7	44.2	44.4	45.7	47.4
1999/00	47.7	42.7	54.9	44.6	45.5	44.3	47.2
TOTAL MILK WEIGHTED IN PROPORTION TO QUANTITY OF FLUID MILK							
1999/00	32.9	22.0	36.8	28.0	34.2	20.9	25.6
TOTAL MILK AFTER DEREGULATION							
2000/01	29.1	29.3	30.6	27.7	26.6	25.0	29.0
2001/02	32.5	33.3	34.5	31.5	28.7	32.7	33.0
2002/03	32.8	24.8	34.8	30.3	28.2	25.9	27.1
2003/04	30.9	26.7	33.8	28.2	27.4	27.2	27.9
2004/05	32.9	31.5	35.0	30.1	27.2	30.8	31.5

Sources: Dairy manufacturers cited in Dairy Australia 2003, p. 6 and 2005, p. 11; and our calculations.

Since the reform of 2000, producers have seen a clear reduction in their share of the consumer dollar.

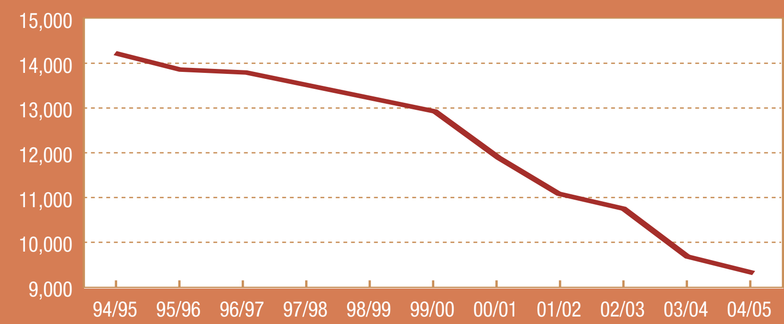
To obtain a 3% decrease in the price of fluid milk, was it really worth cutting the farmgate price of fluid milk by more than one third and losing more than a quarter of the country's dairy farms in five years?

Deregulation of the dairy industry seems to have had an immediate impact on the structure of the production sector. Figure 1.1 shows that the number of dairy farms has decreased at an accelerated pace since 2000/2001, the year of deregulation. While it ranged from 1.0% to 2.4% in previous years, the rate of decrease in the number of dairy farms jumped to 8.2%, 6.7%, 3.6%, 9.8% and 3.7%, in that order, in the years following deregulation.

Finally, as illustrated in Table 1.2 (p. 3), the farmgate price of fluid milk decreased, as Spencer's analysis confirms. His analysis also shows that, since the reform of 2000, producers have seen a clear reduction in their share of the consumer dollar spent to buy a two-litre retail container of fresh milk (Spencer 2004, p. 24). It was the retailers, due to their market power, who were able to increase their share of the consumer dollar. As for processors, the study notes that they are in an overcapacity position and so it seems that retailers can therefore play one competitor against another to obtain lower prices. As in New Zealand in the fluid milk sector, the other links in the dairy industry chain are taking advantage of the sector's deregulation, and not necessarily to the benefit of consumers.

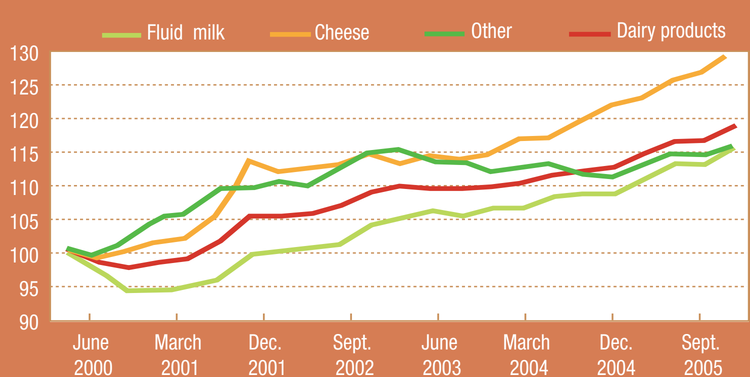
Figure 1.2 shows the trend in the various price indices in current Australian dollars based on an index of 100 in June 2000, when the fluid milk sector was deregulated. It can be seen that the retail price of fluid milk did decrease in the first two quarters following deregulation, driving down the average retail price of all dairy products. Subsequently, the retail price index for all dairy products increased more sharply than the

FIGURE 1.1
Change in dairy farm numbers
Australia, 1994/1995 to 2004/2005



Source: State Milk Authorities cited by Dairy Australia 2003, p. 5.

FIGURE 1.2
Trends in the Consumer Price Index for all dairy products, cheese, milk and other dairy products[1]
Australia, June 2000 to December 2005 (Index 100 = June 2000)



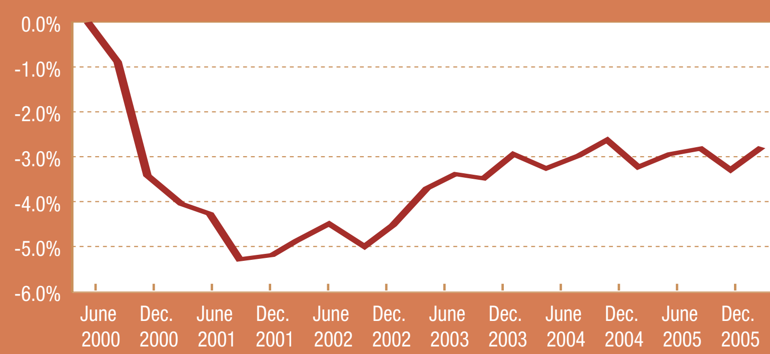
1 Other dairy products includes butter.
Source: Australian Bureau of Statistics, special issue; and our calculations.

In New Zealand – which deregulated its fluid milk sector before Australia – prices reached a level in 2002 that was more than four times that of 1981.

retail price index for fluid milk up to December 2001. However, from that date on, the gap between the two indices, which then peaked at 5.2%, began to narrow, reaching 3.2% in March 2004 and stabilizing at that level ever since (Figure 1.3). Australian consumers thus seem to have benefited from a relative reduction in the retail price of fluid milk, but a very small one. This relative gain should be viewed against the much greater farmgate price decreases sustained by fluid milk producers and the restructuring of the production sector that this triggered. Was it really worth cutting the farmgate price of fluid milk by more than one third to obtain a 3% decrease in the price of fluid milk? Was it worth losing more than a quarter of the country's dairy farms in five years?

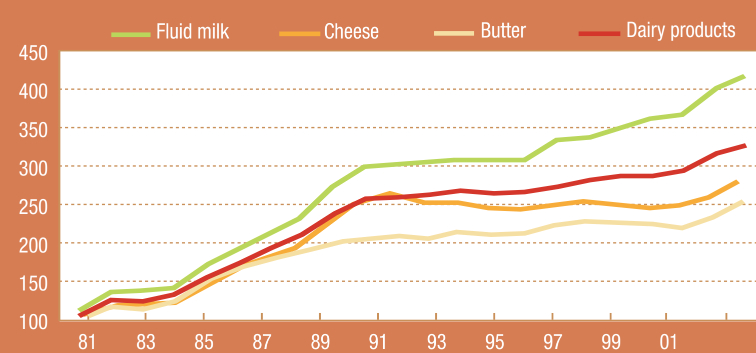
In any case, it is certainly premature to conclude that this reform has been a success from the standpoint of consumer prices, and we will have to wait and see whether the presumed bargain that deregulation was supposed to bring Australian consumers is maintained beyond a short-term horizon.

FIGURE 1.3
Difference between the retail price of fluid milk and that of all dairy products
Australia, June 2000 to December 2005



1 Other dairy products includes butter.
Source: Australian Bureau of Statistics, special issue; and our calculations.

FIGURE 1.4
Trends in the Consumer Price Index of dairy products [1], butter, cheese and milk
New Zealand, 1981 to 2002 (Index 100 = 1981)



1 Consumer Price Index for dairy products and eggs.
Source: MAF New Zealand; New Zealand Statistics, special issue; and our calculations.

It would be presumptuous to suggest that an Australian-style deregulation of the Canadian dairy sector would necessarily lead to any gain for Canadian consumers of dairy products.

In this regard, the New Zealand experience can also be very informative. The deregulation of the fluid milk sector in New Zealand, which was implemented gradually between 1985 and 1993, and which has been total ever since, does not seem, at first glance, to have benefited consumers in terms of price levels (Figure 1.4, p. 5). Not only did consumer prices of dairy products increase more than anywhere else (Australia, United States, Netherlands, France and Canada) over a longer period, but the increase has been the most dramatic for fluid milk, reaching a level in 2002 that was more than four times that of 1981. Nor has deregulation in this sector benefited New Zealand dairy producers, who have lost instead the market power they previously held through regulatory mechanisms that managed the farmgate prices of fluid milk deliveries.

Consequently, a quick analysis of what has happened in Australia in recent years can in no way serve as an ideal reference model. It would be presumptuous to suggest that an Australian-style deregulation of the Canadian dairy sector would necessarily lead to any gain for Canadian consumers of dairy products.

This report contains extracts and partial update of Daniel-Mercier Gouin's study published in November 2004. The full report, which runs to over 100 pages, can be obtained at the following address:
http://www.go5quebec.ca/en/documents.php