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## POLICY FORMULATION IN THE AUSTRALIAN DAIRY INDUSTRY

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### ABSTRACT

The Australian dairy industry is undergoing one of its many and periodic ructions. At question this time is the interstate trading (in particular to Sydney) of fresh (market) milk. The dispute has the potential to cause the breakdown of the Federal and State marketing arrangements for milk and dairy products. This would lead to dramatic falls in milk and dairy product prices and, consequently, dairy farm incomes. Even though Federal and State Ministers and dairy industry politicians have been negotiating throughout the last year and although many solutions have been proposed no firm settlement of the dispute has been reached. The inside story of the conflict from an economist-bureaucrat's point of view is presented in this paper.

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<sup>1</sup> Paper presented at the 32<sup>nd</sup> Annual Conference of the Australian Agricultural Economics Society, La Trobe University, 8-11 February, 1988.

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"From the gentle udder of the placid cow flows a substance more capable than any other of inspiring the meaner instincts of men."

Justice Jerome, commenting on  
a U.S. market milk order

"Consumers' interests come second to others within the [NSW] dairy industry."

"The [NSW] Dairy Conference is a vested interest."

Mr Peter Brownscombe,  
consumer representative, in a  
speech to the NSW Dairy  
Conference.

"At the farm gate, milk is milk."

Mr Justice Robinson  
Deputy President, Australian  
Conciliation and Arbitration  
Commission, in the 19 April  
1985 Milk Price Arbitration.

## 1. INTRODUCTION

The Australian dairy industry became the first Australian agricultural industry to have a marketing board (the Australian Dairy Produce Board) in 1924, and since then the industry has been one of the most heavily regulated and controlled of all of the Australian rural industries. There have been a great number of marketing plans and arrangements since that time, with both Commonwealth and State governments having some control at some time over the marketing of milk and milk products. The result has been a tangled web of regulations which few people in Australia fully understand, and the implications of which even fewer people (if anybody) know. These regulations confer substantial benefits on the industry as a whole, with large transfers from domestic consumers.

In spite of, or perhaps because of, the bewildering number and byzantine complexity of the regulations, the industry is noted for its frequent disturbances and disputes, most often between producer groups. There have been disputes between producers in different States and disputes between producers within a

State. There have been milk blockades to stop movement of milk between States and milk blockades to stop movement of milk within a State. There has even been a Milk Price Arbitration. The latest dispute is between the dairy industries of Victoria and New South Wales. At issue is the right or otherwise of dairy farmers and milk processors of Victoria to sell milk into the premium market of New South Wales. The driving force in this dispute is the considerable price differential between milk for fresh consumption (market milk) and milk for dairy products (manufacturing milk). The down-side risk of the dispute to the industry is the breakdown of the national marketing arrangements for dairy products (the Kerin Plan) and the potential loss of income from the resultant fall in prices. The highly regulated State-run arrangements for market milk, and the high prices these support, are also at risk. Because of these risks, politicians, bureaucrats, the State marketing boards, and dairy industry leaders have invested a lot of resources to resolve the dispute. The legal profession have also prospered, with numerous court actions and litigation from both sides of the NSW-Victorian border.

Agricultural economists have expended considerable effort in evaluating the effects of the many regulations and marketing plans that have been put in place for the industry. Most of the studies and the alternatives proposed by the economists have been concerned with the efficiency aspects of the arrangements. The underlying assumption in these studies is that government intervention is designed to maximise social welfare and attain economic efficiency. That the marketing arrangements of any given time result in inefficiencies is seen as cause for concern, and it is argued that further government action is required to correct these faults (see Inter alia Parish (1962), Lloyd (1971) and Alston and Quilkey (1980)). Furthermore, that the alternatives proposed by them have been greeted with, at best, indifference by producers and consumers troubles the economists, but they continue to fight for the cause (see, for example, Lloyd (1971) and (1985)).

An alternative view of the dairy industry arrangements is from a distributional perspective. That is, consideration of who gains and who loses, and by how much, may give an insight into why the arrangements are as they are, and why changes proposed by economists are not greeted with enthusiasm by the industry and the community. Sleper (1982) uses the framework in a study of the regulation of Australia's rural industries including the dairy industry. He concludes that in many instances the various marketing arrangements and

regulations have been to the benefit of the dairy industry, at the expense of consumers. Furthermore, Sieper argues that the transfers from consumers to producers are unlikely to be in the form of lump-sum transfers, but are derived from regulation. Regulation hides the transfers under the guise of 'being in the public interest'. The general rule is that protection (in the form of regulation) is produced for a political market in which existing industry interests provide the demand and governments the supply (Sieper, 1982).

Sieper's approach goes further towards explaining why certain policy decisions are made, and why past marketing arrangements have been put in place. But, this still leaves the question of how in practice does the government perceive the demand of the competing interests and how the government supplies the appropriate form of regulation out of all the available alternatives; how is policy formulated in practice and what are the processes involved. It also seems to imply that the process of discovery of the optimal form of regulation, from the viewpoint of the regulator and the regulated industry, is a simple one. This is not the case in practice, as is demonstrated in this paper.

The purpose in this paper is to give an inside story of the policy formulation and negotiation processes in the Australian dairy industry from a bureaucrat-economist's point of view. In particular, reference will be made to the recent events in the dairy industry with regard to interstate trade of market milk. The focus will be on the Victorian and New South Wales industries. As well, some preliminary thoughts as to the role of the bureaucrat-economist in policy making are given. It might well be that the economist's role is unrelated, at least explicitly, to the efficiency arguments for and against alternatives. Finally, anomalous and unusual effects of some of the variety of regulations which have come to light during (but are unrelated to the dispute) will be discussed to highlight the difficulties facing regulators in ensuring orderly marketing is maintained and that the optimal regulation is achieved.

## 2. THE DAIRY INDUSTRY

The dairy industry is one of the larger agricultural industries, making up around 7 percent of the gross value of Australian agricultural production and 15 percent of the gross value of Victorian agricultural production. Victoria is the largest milk-producing State and has about 56 percent of Australian dairy farms and produces about 60 percent of total milk produced in Australia. New South Wales,

on the other hand, has about 15 percent of Australian dairy farms and produces about 15 percent of milk. On average, Victorian dairy farmers are the most cost efficient in terms of milk production as south-east Australia is generally the most climatically favoured area to produce milk. Milk production is typically seasonal, particularly in areas such as Victoria which use pasture-based production. The "normal" trend is for high production in spring and low production in autumn-winter. This seasonal pattern is very marked in Victoria but is diminished in NSW due to the use of feed concentrates which is encouraged by the marketing arrangements in that State.

Milk production has traditionally been divided into two sectors: milk for fresh consumption (market milk), and milk for manufactured dairy products. This historically-based division arose because of geographical factors, and because quality and hygiene standards required for the two milk markets differ. It has been perpetuated even though the overwhelming majority of milk produced in Australia meets the standard of quality required for market milk. This is convenient for the dairy industry. The division means that price and market discrimination can be carried out, to the benefit of the industry at the expense of domestic consumers.

About 27 percent of Australian production is used for the premium market milk market. Twenty-five percent of milk production is exported as butter, cheese, skim milk powder, whole milk powder and casein (90 percent of Australian exports come from Victoria) and the remainder is used for domestically consumed manufacturing milk products (including yoghurt, cream, butter, cheese, etc.). However, some 50 percent of Australian dairy farm revenue is gained from the market milk market. The percentage of each state's milk production going to each sector varies considerably between states, as does the revenue from each sector. For example, 12 percent of Victorian milk production goes to market milk, and around 25 percent of revenue comes from market milk sales. Victoria also exports around 40 percent of its milk as dairy products. On the other hand, 60 percent of NSW milk production goes to market milk, and around 75 percent of revenue is from market milk sales. Very little NSW milk is exported as dairy products.

## **2.1 Current Marketing Arrangements**

The dairy industry in Australia is characterised by considerable and long-lasting government intervention. Commonwealth legislation underpins orderly marketing arrangements in the manufacturing sector and State legislation does likewise in the market milk sector. These arrangements have had a major effect on profitability and trends in the industry. High levels of assistance have been afforded to milk producers, particularly when compared with other grazing industries (Johns, 1985). There are substantial linkages between the two sectors with the prices in the manufacturing sector having significant influence on prices in the market milk sector.

### **The Kerin Plan**

The latest in a long line of national dairy marketing arrangements was introduced in July 1986 and is called the Kerin Plan. The principal objective of the Kerin Plan is to progressively reduce domestic price support of dairy products to a level no higher than the price level at which New Zealand dairy products could be sold in Australia on a fair trade basis (Dairy Produce Bill 1986, Second Reading Speech by the Minister for Primary Industry, the Hon John Kerin). For the time being, this 'fair trading basis' is defined as 130 percent of the average Australian export price. The Kerin Plan is essentially a tax/subsidy home price scheme which supports the price for export product explicitly, and supports prices for domestic manufactured milk products and market milk implicitly. The tax is collected on all milk production and is paid as a subsidy on exports, raising the domestic price of dairy products and providing a floor price for market milk.

The key elements of the Plan are:

- i. A levy on all milk produced in Australia (called the All Milk Levy). This is around 40 c/kg;
- ii. The money collected from the All Milk Levy (AML) is paid into the Market Support Fund. Market Support Payments (MSP) equal to a maximum of 30 percent of the estimated average export price for the coming season are paid to manufacturers of the exported product from the Market Support Fund;
- iii. There are also Product Levies on butter and cheddar-type cheese. These Product Levies are imposed on domestic sales of leviable product and are repaid on export sales of that product as Supplementary Market Support

**Payments.** These are to be gradually phased out so that eventually only the MSP support dairy prices;

- iv. Inclusion of the "comfort clause" in the legislation. This clause permits any State Government Minister with the responsibility for agriculture to request suspension of the All Milk Levy if there is serious disruption to the marketing arrangements for milk. The Federal Minister must suspend the Levy "as soon as practicable" after 60 days following a request, unless a majority of Ministers attending a special meeting of Australian Agricultural Council (AAC) vote not to suspend the Levy. The Federal Minister can reinstate the Levy, if it is suspended, whenever he chooses without recourse to AAC. When the Levy is suspended, MSP's cannot be made and so there is no support for dairy product prices;
- v. Major reviews in 1988/89 and 1991/92 will be conducted by the Industries Assistance Commission. There is also a "sunset clause", terminating the legislation on 30 June, 1992.

#### Arrangements for market milk

Each State operates and manages some form of marketing arrangement for market milk. These marketing arrangements rely on monopoly control of intrastate production and sales of market milk by a State-run statutory marketing authority. Milk for market milk purposes is differentiated from other milk and as a result, premium prices for market milk are paid to farmers and others in the marketing chain. Supplies to the market milk sector are restricted, forcing up the price for market milk. This, of course, means higher prices to the consumer, with a transfer of consumer surplus to the producers, distributors and processors, and some deadweight loss.

The statutory marketing authority responsible for the marketing of market milk in Victoria is the Victorian Dairy Industry Authority (VDIA), which is responsible to the Minister for Agriculture and Rural Affairs. The authority in New South Wales responsible for the market milk arrangements is the New South Wales Dairy Corporation (NSWDC).



Historically, the individual state arrangements have not been linked with one another and have ostensibly developed due to geographical factors, quality and hygiene. In spite of Section 92 of the Constitution, a number of elements have ensured that only a minor trade in market milk between states has taken place, permitting the various state dairy marketing boards to raise market milk prices above import parity for each state.

Each state in Australia tries to ensure that adequate supplies of milk are produced from its own dairyfarmers to meet its market milk demand. To do this, either pooling of market milk returns or market milk quotas are used. For example, under a pooling arrangement, in Victoria, returns from the sale of market milk are distributed as a market milk premium to all dairy farmers each month equitably in proportion to their individual production. The proportion of each farmer's production which attracts the premium is determined according to the percentage of milk produced in Victoria which is required for market milk in that month. As well, payment of a predetermined price incentive (known as the winter milk incentive) ensures adequate supplies of milk in the low production months of April, May and June.

On the other hand, for example, NSW relies on quotas or entitlements to supply a fixed volume of milk for market milk year round. These quotas are non-negotiable and non-transferrable, although they are expropriable. For example, if a producer consistently under-supplies milk relative to his market milk entitlement, then he is liable to have some of the quota taken away, without compensation. The quota has considerable value to the dairyfarmers of the State, and erosion of this value is not taken lightly. The NSWDC also has the power to release additional quota, reducing the value of existing quota.

In both cases the dairy marketing board fixes all prices and margins from farm gate to retail, and regulation covers production, processing, transport, distribution and retailing. Both the VDIA and NSWDC license all dairyfarms, factories, milk processors and distributors. In addition the NSWDC licenses a number of Victorian milk processors who sell milk into the Border areas of NSW.

## 2.2 The Commonwealth Constitution and the Trade Practices Act

The Constitution and the Trade Practices Act constrains action by both the State or Commonwealth Governments which attempts to prevent or restrict interstate trade in market milk. The Constitution places limits on the actions of statutory marketing authorities and governments with respect to the control of interstate trade. Section 92 requires that "...trade, commerce and intercourse among States...shall be absolutely free". A number of Court (High, Federal and Supreme Court) decision's have upheld this constitutional right of interstate traders (see Coper, 1978, 1983 and 1985 for more information on this). Under the general court interpretation, if a processor decides to trade milk interstate, he is perfectly free to do so, and there is nothing legally any Government can do to prevent the trade. This was shown particularly in regard to milk in the High Court [North Eastern Dairy Co. Ltd. vs Dairy Industry Authority (New South Wales) (1975)] and in the Supreme Court of New South Wales [Midland Milk Pty Ltd. vs New South Wales Dairy Corporation (1986)].

The Commonwealth Trade Practices Act prohibits restrictive trade practices, viz. restraint of trade, monopolization, resale price maintenance, anti-competitive exclusive and discriminatory dealing and anti-competitive mergers. In particular, Section 45(D) of the Act prohibits other groups (such as trade unions) from performing secondary boycotts, and, for example, blockading the transport and sale of milk. Statutory boards have specific exemptions with regard to trade within a State, as does the Crown. The Trade Practices Act comes into its own, though, when trade is between States, and the Act then prohibits discriminatory dealing and monopolization.

Despite these constitutional and legal limitations on preventing interstate trade in market milk comparatively little milk has been traded between States, even though the differential between the prices for market milk and manufacturing milk is large. The following section discusses the interstate trade in market milk, reasons for low volume traded between States, and the recent dispute.

### 3. INTERSTATE TRADE IN MARKET MILK

Nearly all the disputes in the dairy industry over the interstate trade of market milk have been between New South Wales and Victoria. New South Wales is the State most vulnerable to shortfalls in meeting its demand for market milk, especially in the low production period of the year. It is also the State with the highest consumption of market milk relative to its milk production. Other States have smaller demand relative to production and therefore have less difficulty meeting this demand.

Victoria is in the best position to take advantage of this situation and could supply any NSW market requirement, regardless of the time of the year. As discussed in the previous section, Victoria is the largest producer and for 87 percent of its production receives only manufacturing milk prices. Some Victorian producers see the large NSW market as the golden goose, with its high retail prices as the golden egg. Other Victorian producers believe that any interstate trade in market milk outside orderly marketing arrangements will not only kill the golden goose, but also upset the cozy Victorian arrangements. Those favorable to interstate trade generally believe it is unfair that Victoria is the most efficient (and largest) milk producer, but is only permitted access to a fixed proportion of the lucrative market milk market in Australia. However, to trade market milk into NSW, until fairly recently, has been taboo. Possible punitive action through Commonwealth legislation, fear of retaliatory action by producers in other States, and a desire by those within the industry not to upset traditional arrangements have combined to restrict the interstate trading of market milk (IAC, 1983).

Prior to the introduction of the Kerin Plan in 1986, unproclaimed Commonwealth legislation, which provided for a market milk levy to be imposed<sup>4</sup>, was used as the stick to keep rogue producers and processors (mostly Victorians) in line. The stick of the Kerin Plan is the comfort clause, which provides for suspension of the all milk levy and hence the support arrangements for manufacturing milk. The effect of the comfort clause in the current dispute is discussed later in this section.

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<sup>4</sup> Under this legislation, a levy on all market milk production would be imposed, with the proceeds being returned to the State in which the sales of market milk were made. This would have the effect of substantially reducing the price received for market milk sold interstate, possibly to manufacturing milk price level.

Even with the various discouragements of trade there has been some interstate trading of market milk for many years, although it has been comparatively small relative to the total production of milk in Victoria and Australia. Several Victorian companies, including Midland Milk Pty Ltd, Murray-Goulburn Co-operative Co. Ltd., and Sandhurst Milk Processors Pty Ltd have been involved in interstate trade of market milk to border districts of New South Wales (Wagga Wagga, Albury, Broken Hill, the Riverina) since at least the mid 1970s. This is the so-called traditional Border Trade milk. The NSW and Victorian industries have come to an agreement, with NSW to some extent turning a blind eye to the Border trade although the NSWDC does license all Victorian processors who trade in NSW. Even with this licensing, the NSWDC is powerless to control the sales of milk by these Victorian processors, except for ensuring adequate quality standards.

Interestingly, the prohibition on interstate trade in market milk does not extend to trade in raw milk for manufacturing purposes nor to trade in manufactured products. This is viewed as a perfectly fair thing by all in the industry.

For example, processors in NSW currently import a large volume of Victorian manufacturing milk (approximately 100 MI). This milk may be used for any purpose (including market milk) and Victoria cannot identify the purpose. It is certain that NSW uses at least some of the raw milk from Victoria to manufacture, among other things, short shelf-life products (such as yoghurt, cream, and so on) which are in turn traded back into Victoria. Now, this is fine as both States benefit and it is supported by s.92 in allowing free trade between States. However, the trade in manufacturing products also doesn't disrupt any cozy State orderly marketing scheme. Trade in market milk has the potential to disrupt both State's orderly marketing schemes, by providing ruinous competition to the monopoly position of the State milk marketing boards.

This contradiction does not seem to concern the NSW industry, for good reason. The NSW processors benefit from this trade, being able to more fully utilise their processing and manufacturing capacity. If the raw milk were being used for market milk, neither the NSW producers nor the NSWDC would be concerned providing it was being used as a substitute for NSW milk which is of inferior quality and for which the processor has paid full price; that is, providing the NSW processors are not selling the raw Victorian milk as market milk in addition to the milk purchased through the NSWDC.

The interstate trade in raw milk also does not concern the Victorian industry greatly. While the issue has been raised several times in the negotiations in the past 10 months, it has not been a major concern. First, the Victorian industry cannot identify the use of the raw milk. Second, Victorian dairy factories are benefiting from the sale, as the price they receive for the raw milk is likely to be higher than the realizable price from products produced in the Victorian factories; why else would the Victorian factories sell it to NSW? In turn, the producers supplying these factories benefit from the higher prices. Finally, all other Victorian producers are relatively unaffected by the trade.

But this is a digression. We now turn to the topic of interstate trade in market milk and policy making. The major events in the past year or so in the interstate trade issue are detailed in the following sections. Some comment is also provided regarding the players and the some of potential gains and losses to each.

### 3.1 Phase I - The First Skirmishes

Of particular interest in this paper are the events of the past year or so. However, certain events prior to that have had some bearing on policy decisions which were made during the past year. In particular, previous court decisions made in regard to interstate trade in milk are important. To this end a calendar of important events in the interstate trade of market milk since 1975 is provided as Appendix A.

The first major dispute in interstate trade in market milk was finalised in November 1975. A Victorian milk processor, the North Eastern Dairy Co. Ltd. (NEDCO) had been selling market milk, which had been processed in Victoria, in stores in Wagga Wagga since 1973 and were registered by the Dairy Industry Authority of NSW. The Dairy Industry Authority of New South Wales (the predecessor of the NSWDC) attempted to prevent this trade of market milk by threatening to cancel NEDCO's licence. The case was taken to the High Court of Australia, and in November 1975, the High Court found in favour of NEDCO in that actions of the Dairy Industry Authority of New South Wales contravened

s.92. NEDCO<sup>5</sup>, while remaining licensed by the Dairy Industry Authority of NSW, continued to trade milk into the Riverina region of NSW. The lines had been clearly drawn by the High Court decision, and other Victorian milk processors traded market milk into the Border regions of NSW<sup>6</sup>. At the time, it was believed that the decision would herald significant deregulation of the marketing arrangements of market milk, causing a collapse of the dairy industry. This did not eventuate.

In April 1984, Midland Milk began selling market milk in Sydney. This milk was discounted compared both to the retail price in NSW, and the retail price in Victoria. The NSW Dairy Corporation attempted to prevent this sale by fixing a minimum retail price for milk, and by setting health standards which were different to those for milk processed and sold in NSW. Moreover, the Victorian Government, fearful of a breakdown in orderly marketing, investigated a number of options designed either to prevent the trade of market milk or to trade milk to NSW under the orderly marketing arrangements. All attempts to restrict interstate trade were unfruitful. In particular, in July 1986 the NSW Supreme Court ruled that the NSWDC could not prevent Midland Milk from selling milk in Sydney at discounted prices and that uniform health standards were to apply to all milk sold in NSW, regardless of the source.

Once again this led dairy industry leaders, politicians and bureaucrats to the conclusion that the end was nigh for orderly marketing arrangements for market milk. It appeared inevitable that Midland Milk, or some other Victorian processor, would once again begin to trade discounted market milk to Sydney.

The new national milk marketing arrangements (the Kerin Plan) began at around the same time in July 1986. Direct beneficiaries of the Kerin Plan are those states in which dairy products make up a major source of revenue, particularly if the products are exported (i.e. Victoria, Tasmania, and, to a lesser extent, South Australia). However, all states' dairy industries benefit from the support the arrangements provide to milk prices. Even so, the comfort clause was included in the legislation at the request of the market milk states - NSW, Queensland, and West Australia. Its purpose was clear; if interstate trade in

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<sup>5</sup> NEDCO has since become part of Murray-Goulburn Co-Operative Co. Ltd.

<sup>6</sup> Although the supply of market milk by the Victorian processor Sandhurst had been long-established.

market milk broke out the trade would come from the manufacturing milk states (Victoria, Tasmania, and South Australia), and then the comfort clause would be invoked and the export subsidies stopped. This, it was reasoned, would hurt these manufacturing milk states most.

There was much action behind the scenes even before any further trade took place. The Victorian Minister for Agriculture and Rural Affairs, Mr Walker, established a Working Party to consider the implications of further interstate trade in market milk, and options for alternative orderly marketing arrangements. While the objective of the working party was to establish a rationale for change for the supply and marketing of market milk throughout Australia, this essentially meant to the benefit of Victoria's dairy farmers. If the marketing arrangements for market milk were freed up, allowing access of Victorian market milk to other States, then Victoria would benefit, assuming the market milk premium was not eroded.

The charter of the Working Party was to maintain orderly marketing arrangements and the Working Party did this by identifying a number of options for action. These included a do-nothing option, a two-state market milk pool, a Commonwealth market milk levy, and purchase of NSW market milk quota by the VDIA. The two-state market milk pool option was the preferred option and no option to deregulate the industry was canvassed, except implicitly under the do-nothing option.

The report by the Working Party was followed by some discussion between the NSW and Victorian industries about the possibility of further interstate trade and the possibility of establishing a two-state market milk pool. Informal discussions were also held between the Victorian and NSW Ministers for Agriculture. These discussions came to little.

### 3.2 Phase II - The First Attempt

The scene was set. On 9 April 1987 Midland Milk resumed trading discounted market milk into Sydney, supplied under contract by the VDIA. Midland bought the milk from the VDIA at a price below that paid for milk sold as market milk in Victoria. Although no price determination had been made by the VDIA for this contract as required by the Victorian Dairy Industry Act, the Authority used allowances to provide a discounted price to Midland. The VDIA had used such

allowances for a number of years for Border trading, UHT milk and other circumstances for both trading within Victoria and across state borders. The VDIA Board believed that the contract with Midland would give the VDIA some control over the interstate trade, permitting it to maintain orderly marketing. As well the VDIA Board believed that all Victorian farmers should share in the gains from trading in NSW, via the pooling arrangement. The volume of milk traded was around 17,000 litres per day, or just 1 percent of the NSW market, sold in 2 litre containers. Although the volume was small the reaction by the NSW dairy industry was swift and decisive.

First, the NSWDC reduced the price of all 2 litre containers of milk sold throughout NSW to match the price at which Midland (through the Jewel Foodstores chain) was selling its milk in a few stores in Sydney. This may have reduced the number of containers sold by Midland somewhat, but it certainly and substantially reduced the revenue the NSW industry received from the milk sold. The reasoning for the across-the-board price discount is not clear, although clearly the winners were the NSW consumers. Equally clearly the losers were any operators in the NSW marketing chain for market milk, from farmers to retailers; all bore the cost (up to \$1 million) of the temporary price reduction.

Secondly, the NSW Minister for Agriculture invoked the comfort clause of the Kerin Plan. Under the comfort clause the Commonwealth Minister for Primary Industry must suspend the all milk levy within 60 days unless a majority vote by the Australian Agricultural Council decides otherwise. A tied vote would result in suspension of the Levy.

Without doubt, prices for all milk would fall if the Levy was suspended. Suspension of the Levy would mean that Market Support Payments would have to cease. With no subsidization of export prices, domestic prices for manufacturing products would fall. Farm gate prices for milk for manufacturing purposes would fall. This would place additional and much greater pressure on the arrangements for market milk. The large gap between manufacturing and market milk prices (market milk prices are currently more than double the manufacturing milk prices), s.92 of the Constitution and the Trade Practices Act which guarantee free trade between States, and the increasing vertical integration of "multistate" supermarkets are all factors contributing to the pressure on the market milk arrangements. What is in doubt is the extent of the fall. However, regardless of the extent of the price drop, farm incomes would be reduced. On the other



hand, consumers would benefit and there would be gains in efficiency in the long-term. But, only the effect on farm incomes was considered in any depth by all the players and even the consumers were sympathetic to the producer's potential plight.

At that stage if a vote had been taken, the likely outcome was NSW, Queensland and West Australia for suspension and Victoria, Tasmania and South Australia against suspension. The result hinged on the vote from the Northern Territory and, to a lesser extent, the Commonwealth. Due to a squabble between the two Northern Territory farmers and the Commonwealth over non-payment of the levy, it was almost certain that the Northern Territory would vote to suspend the levy. Thus, two dairyfarmers from the Northern Territory could upset the whole structure of the dairy industry arrangements, and 10,000 dairyfarmers from Victoria could do little to avoid it (although later events showed that the Victorians tried hard).

The Commonwealth vote would, at best, tie the vote. It was still important, though, to have the Commonwealth Minister vote against suspension of the levy. The second part of the comfort clause allowed for the Commonwealth Minister to reinstate the levy whenever he wished. So, some Victorian effort went into persuading the Commonwealth Minister to vote against suspension of the levy, and so provide a case for him to reinstate the levy at a later date (if that were necessary).

The majority of the Victorian effort went in negotiating with NSW representatives, analysing the effects of breakdown of the Kerin Plan, and considering options. Again, a two-State market milk pool was high on the agenda. At the same time the VDIA to give notice that it would terminate its contract with Midland in early June. The reason given for termination was that Midland had breached the contract in that Midland had not provided the required surety. While this was perfectly accurate, termination of the contract also assisted the negotiating process.

Soon after, a temporary agreement with NSW was struck and as part of the agreement the NSWDC was to purchase 1 percent of NSW market milk requirements from the VDIA for three months, the agreement terminating on 22 August. Any milk sold in Sydney by Midland (or any other Victorian processor) would be offset against this 1 percent. Negotiations on more permanent sharing

arrangements were to be chaired by Mr Pat Rowley, President of the Australian Dairy Farmers Federation (thus, the negotiations were called the Rowley Committee), with representatives from the NSW and Victorian industries on the Committee. The objective of the Rowley Committee was clearly to maintain, as best possible, the market milk arrangements in each State, but at the same time satisfying both the Victorians desire for greater access to the Australian market milk market and allaying the NSW fear of losing the market milk premium they believed was rightfully theirs. Again the option of deregulating the industry was not raised, except as a threat by either side (invoke the comfort clause or trade market milk interstate regardless).

After termination of its contract with the VDIA, and after some profitable negotiations with the Victorian Minister and the Authority, Midland Milk ceased trading market milk to Sydney. Around this time the Minister directed the VDIA to provide for an allowance of 0.97 cents per litre (later reduced to 0.55 cents per litre) of market milk for all country processors for the wholesale distribution of milk (as compensation for distance from the Melbourne market). While this allowance provided considerable gains for country processors, it was also fair in its reasoning. However, it was to cause major problems later in the year when city-based processors challenged the decision. This will be discussed later.

### 3.3 Phase III - The Victorian Milk Plan

While the negotiations were continuing, but not progressing, very little further happened until August 1987. Midland resumed trade of market milk to Sydney on 4 August. The same volume was involved, but this time Midland was being supplied directly by dairyfarmers under contract. There were half a dozen farmers involved in supplying Midland, one of which was a NSW farmer.

New South Wales responded by again invoking the comfort clause. This time it looked serious. The Victorian Government responded by establishing a milk think tank (the Think Vat) with economists and dairy industry specialists from DARA and the VDIA. The team's brief was essentially to 'save the industry'. Even though negotiations continued, prospects for saving the industry (from itself?) looked poor.

The Think Vat took its job seriously and set about saving the industry by investigating ways in which alternative arrangements could provide assistance

close to that provided by the Kerin Plan. There were no explicit thoughts of deregulating the industry, although the most likely outcome for many of the alternative plans was deregulation through breakdown of the plans. Gone also were any ideas of a two State agreement (whether by pooling or whatever). The Think Vat concentrated on developing a Victorian arrangement that was capable of supporting domestic prices for manufacturing dairy products and Victorian market milk prices in the event of a collapse of the Kerin Plan. Analysis of the impact of alternative outcomes on prices and farm incomes was also done by the Think Vat.

Several options were considered, including quotas, direct price regulation and levy-subsidy arrangements. Legal and administrative considerations led the Think Vat team to propose a levy/subsidy arrangement called the Victorian Milk Plan. Under this Plan manufacturing milk prices would be supported by voluntary arrangements similar to the Kerin Plan. Victoria would be relying on its market power in manufactured dairy products to maintain the arrangements. Of course, there would be a free-rider effect, with manufacturers in other States benefiting to some extent from the floor price provided by the Victorian scheme. There was some consideration of including South Australia and Tasmania in the Plan. Existing arrangements for market milk were to be retained, with the addition of a milk war strategy managed by the VDIA. The milk war strategy involved selling significant volumes of discounted market milk into Sydney, and other States. The Victorian Milk Plan was thought to have the potential to provide support to the industry for some time, although eventual breakdown of the Plan was likely. The Victorian Milk Plan had the tacit support of a number of the major Victorian manufacturers. Clearly in this process media campaigns by Midland and other players had changed the course of the debate, and it was not surprising that the Victorian Government joined the action with a similar campaign.

In late August, leaders of the NSW Dairyfarmers Federation and the United Dairyfarmers of Victorian reached agreement on interstate trading of market milk. The agreement provided limited access to the NSW market for Victorian milk, with Victorian purchasing quota for entry, the introduction of a Commonwealth market milk levy, and a limit on the amount of export sales attracting Market Support Payments. The industry leaders met with the Commonwealth Minister, Mr Kerin, to discuss the agreement, but immediately disagreed about the details. Mr Kerin understandably rejected the 'agreement'.

The date had been announced for the AAC meeting to decide on suspension or otherwise of the all milk levy. It seemed to many involved in the dispute that no agreement between the States would be reached before hand, and that a vote would be taken. To help the Victorian cause along, representatives from the Victorian and South Australian industries visited the two Northern Territory dairyfarmers to gain their support. There has been an accusation that an offer to pay the NT farmers all milk levy contributions was made. In return, the NT farmers would persuade the NT Minister to abstain from voting at the AAC. The NT Minister was not agreeable to this proposal.

For all this, the interstate trade of market milk had ceased temporarily. After a meeting between Jewel Foodstores, the NSW Trades and Labour Council and the NSW Minister, Jewel declared a 21-day moratorium on the supply of Midland milk to its stores. But the process by now had a momentum of its own, and there was no sign of either Victoria or NSW backing down. It did not matter, the moratorium was lifted before the AAC meeting and Midland resumed trading to Sydney.

### 3.4 The Australian Agricultural Council Meeting and Beyond

The Victorian Minister went to the AAC meeting in October 1987 with a detailed contingency plan and details of the effects of collapse of the Kerin Plan on dairyfarmers in all states. All involved in the dispute expected the worst. What was not expected was the outcome. Instead of going to a vote, the NSW and Victorian Ministers met and, without the presence of any advisors, struck an agreement that had not been considered, at least not by the Think Vat.

Under the agreement, Victoria is to supply 3 percent of the NSW market milk requirements in the form of bulk milk on a VDIA to NSWDC basis from 1 December 1987. The volume of milk traded by Victorian processors under the traditional Border Trading (about 1 percent of the NSW market milk consumption) is to be included in the 3 percent. The percentage access is to increase by 1 percent each year until December 1989 (i.e. a total of 5 percent of the NSW market milk requirements). The agreement is on provision that no milk processor trades market milk interstate. Details of the agreement are to be finalised by negotiation between the two State industries.

The agreement was greeted with enthusiasm by all parties involved, as it seemed to herald continuation of orderly marketing. The agreement was supported and ratified by the Victorian dairy industry at a meeting with the Victorian Minister, Mr Walker, later in October. At the meeting Mr Walker outlined details of stricter enforcement of licensing conditions for the Victorian industry, and suggested that new restrictions and changes to the legislation would be considered if the agreement was not honoured by Victorian milk processors. Midland Milk indicated then that it would toe the line, and halt trading to Sydney. This it did not do. Midland maintained its trade to Sydney and threatened the NSW/Victoria Agreement. To this end the Victorian Minister sought possible changes to the Victorian Dairy Industry Act, with the aim of reducing the incentive for trade interstate.

At a further meeting with the industry, Mr Walker made it clear that he believed that orderly marketing arrangements were of great benefit, both to the industry and to consumers, and that the Victorian Government would try to maintain orderly marketing of milk. At this meeting the Minister foreshadowed changes to the Dairy Industry Act which would ensure that all milk processed into market milk by licensed Victorian processors would only be obtained from the Authority. That is, there would be no further direct supply of milk for market milk purposes from farmers under contract. This not only affected Midland Milk, but also affected a number of other processors. The Minister assured all processors that the amendments would not affect their activities, providing these activities were within the orderly marketing guidelines. In particular, the Minister assured those processors involved in Border Trading and interstate trade of UHT milk that they would not be disadvantaged; it was intended that the VDIA would use allowances (i.e. provide discounts) in these cases. The proposed amendments were passed by Parliament and proclaimed in December 1987.

A number of court cases which had some bearing on the issue were being conducted throughout this period. In particular, three city-based Victorian milk processors had challenged the right of the VDIA to grant allowances, specifically the country processor allowances. Mr Justice Hampel of the Victorian Supreme Court found that the Minister's direction to the VDIA concerning the country-processor allowances was outside the power given in the Act. This meant that, unless a price determination was made for a particular activity by the VDIA, then all allowances were invalid. The decision was made after the changes to the legislation were passed and proclaimed. Therefore, the plan for the VDIA to use

allowances for those processor's involved in legitimate Border Trading was blocked. These processor's are greatly disadvantaged as they are required to buy all milk for market milk purposes at the VDIA determined price for market milk. In turn, the VDIA cannot make a price determination for Border Trading market milk, as this would also have to apply to milk sold to Sydney, as the Trade Practices Act prohibits price discrimination.

In addition to this case, Midland Milk and Jewel Foodstores sought and gained an injunction from the Federal Court restraining the VDIA from halting supply of milk to Midland, among other things, which the VDIA had sought to do as part of the new, tougher licencing conditions. Midland and Jewel also sought a direction from the Court requiring the VDIA to supply a fixed quantity of milk to Midland at a discounted price. After arguments from the VDIA legal counsel that under s.54 of the Trade Practices Act the VDIA was prohibited from discriminating in price between clients, the Court ruled in the VDIA's favour.

Midland Milk is still trading milk to Sydney, and agreement cannot be reached for legitimate VDIA-NSWDC trade until Midland stops trading. In attempting to improve the current legislation and maintain orderly marketing of market milk, the regulators have made matters considerably worse and have not restricted the interstate trade! How difficult it is for regulators to attain the optimal regulation.

#### 4. THE ROLE OF ECONOMISTS

What has the role of the economist been in this the latest of many dairy industry quarrel? On face value, it seems economists do the bidding of their employer-master. For the bureaucrat-economist this means providing a politically expedient answer to the many vexed questions raised by pressure groups. These pressure groups in turn often have economists working for them. This has meant that the role of bureaucrat-economists has been to try and preserve the status quo, or something very like it. The dairy industry groups have tried to shore up arrangements which undoubtedly and overwhelmingly benefit their members. Statutory marketing boards have tried to ensure that the same orderly marketing arrangements are kept in place for fear of having competition ruin their lives.

Efficiency and serving 'the common good' has apparently come second to the political process of satisfying competing demands. Of course, one may advance

arguments for economists doing this. The social disruption of removal of the orderly marketing arrangements overnight that breakdown of the Kerin Plan implies would be considerable, leading to large social costs. For example, analysis by the Think Vat suggested that as many as 3,000 dairyfarmers (out of 10,000) would leave the Victorian industry over 3 years. A significant number of milk processors and distributors would also be bankrupted. Should dairyfarmers and others be paid compensation, and who should pay? Moreover, the efficiency gains from the deregulated dairy industry to offset these social costs may be some time coming, and some would argue may never occur.

Furthermore, it is not altogether clear that the bureaucrat-economists' advice and alternative arrangements were not pushing the industry towards deregulation. None of the alternatives proposed by the Think Vat could have been kept for any great length of time, and there would have inevitably been a breakdown, with dairy companies responding to competition. There could be some merit in economists in government departments and statutory authorities deregulating agricultural industries slowly and quietly, and not overtly. More could be achieved, with less protest from the vested interests, by putting in place arrangements in which the competition places greater and greater pressure on the arrangements, until the players in the game see the benefit of deregulation.

There is also the issue of who should make the value judgements about what is 'good' and what is 'bad'. Should the bureaucrat-economist make this judgement, and if so, how can he be assured of his objectivity? Generally the advice given the experienced to the young player is that it is best to leave the value judgements to the democratically-elected politicians, after all that is what they are there for. Under this advice the best the bureaucrat-economist can do is to provide alternatives to the political masters, and let them be the judge. Sometimes the bureaucrat-economist has some flexibility and can present an option for deregulation in the set of alternatives. At other times the job description is narrow and there is no room to move in providing deregulation options.

## 6. CONCLUSION

Thus, in spite of all the attempts of regulators, politicians and economists, the dairy industry may be deregulated yet. The Constitution, the laws of the land, operators such as Midland milk and Jewel, and even their own regulations have made it difficult for regulators to maintain the orderly marketing arrangements. While there have been a number of moves by both the Victorian Government and the VDIA, and their NSW counterparts, to resolve the dispute any success may only be of a temporary nature. The great difference between market milk and manufacturing milk prices, the guarantee of free trade between States, and the Kerin Plan itself provide pressure for deregulation of the milk marketing arrangements in Australia.



**APPENDIX A**  
**CALENDAR OF EVENTS**

- 1973-1975** North Eastern Dairy Co-operative (NEDCO) trades milk into New South Wales. The Dairy Industry Authority of NSW attempts to prevent the trade. High Court finds in NEDCO's favour under s.92.
- April 1984** Midland Milk sends market milk to Sydney for sale through Jewel Foodstores supermarket chain. Blockades of trucks transporting the milk by farmers and the NSW Branch of the Transport Workers Union. NSW Dairy Corporation attempts to license all interstate processors selling milk in NSW. NSW Supreme Court action taken by Midland Milk under s.92 of the Constitution.
- 4 July 1986** Mr Justice Rogers of the NSW Supreme Court finds in favour of Midland Milk, upholding the right of Midland Milk to trade market milk interstate.
- September-** Ministerial Working Party considers the possibility of interstate
- December 1986** trade in market milk and the alternative arrangements and options for Victoria and NSW.
- December 1986 -** Discussions between NSW and Victorian industry representatives
- January 1987** on sharing of the NSW market milk market.
- February 1987** Discussions between Victorian Minister for Agriculture and Rural Affairs and NSW Minister for Agriculture. No agreement reached.
- 9 April 1987** Midland Milk resumes trade into Sydney with milk supplied under contract by the Victorian Dairy Industry Authority. Section 92 of the Constitution and s.45(D) of the Trade Practices Act prevent any retaliatory action by NSW or the unions. Supply of milk to Sydney by Midland Milk is around

17,000 litres per day, or around 1 percent of the Sydney market.

- 10 April 1987**      The NSWDC reduces the price for all 2 litre containers of milk sold throughout NSW in line with the retail price sold by Midland through Jewel Foodstores.
- 16 April 1987**      The NSW Minister for Agriculture, Mr Hallam, invokes the "comfort clause" of the Kerin Plan, threatening the All Milk Levy and Market Support Payments for the manufacturing milk sector, and all milk marketing arrangements in Australia.
- 1 May 1987**        The VDIA announces termination of its contract with Midland Milk due to a breach of the contract by Midland Milk. Contract to finish in 30 days. Negotiations between the NSW and Victorian industries continue, with the possibility of Victoria gaining temporary and limited access to the NSW market being raised.
- 5 May 1987**        NSW Minister for Agriculture, Mr Hallam, announces he will withdraw his request for suspension of the all milk levy.
- 5 June 1987**        Australian Agricultural Council meeting to discuss interstate trade in market milk issue.
- 10 June 1987**      Midland Milk ceases supplying milk to Sydney for two months.
- 29 June 1987**      The Victorian and NSW dairy industries agree to a 90 day peace arrangement with access of Victorian bulk milk equal to 1 percent of the Sydney market milk consumption on a VDIA to NSW Dairy Corporation (NSWDC) basis for a three-month period. During this time the two industries were to arrive at a negotiated settlement mediated by Mr Pat Rowley, President of the Australian Dairy Farmers Federation.

- 4 August 1987** Midland Milk resumes market milk sales to Sydney using milk supplied directly to it by dairyfarmers under contract. No agreement reached between the Victorian and NSW dairy industries. The NSW Minister invokes the comfort clause for a second time, requesting suspension of the All Milk Levy.
- 14 August 1987** Rowley Committee presents report to meeting of AAC. NSW and Victoria have agreed to a 30 day extension to the agreement.
- August-December 1987** Victorian Department of Agriculture and Rural Affairs establishes a think tank to consider outcomes of the dispute and to develop strategy options.
- 25 August 1987** United Dairyfarmers of Victoria (UDV) and NSW Dairyfarmers Federation (NSWDF) reach agreement on interstate trading of market milk. Proposal includes the introduction of a Commonwealth Product Levy on market milk, a limit placed on the amount of export sales attracting Market Support Payments and limited access of Victorian market milk through purchase of NSW market milk quota.
- 28 August 1987** Representatives of the UDV and NSWDF meet with the Minister for Primary Industries and Energy, Mr Kerin, to discuss proposal. Immediate disagreement between the industry representatives at the meeting. Mr Kerin rejects the proposal.
- 2 October 1987** At a meeting of the Australian Agricultural Council the NSW Minister and the Victorian Minister for Agriculture and Rural Affairs, Mr Walker, negotiate an agreement. Under this agreement, Victoria is to supply 3 percent of the NSW market milk requirements in the form of bulk milk on a VDIA to NSWDC basis from 1 December 1987. This is to increase by 1 percent each year until 1 December 1989 (i.e. a total of 5 percent of the NSW market milk consumption). The price of this milk is to be the equivalent NSW factory gate price. That is, about equal to the price charged by the

VDIA for milk supplied to Victorian milk processors but with the VDIA being responsible for the cost of transport to NSW. The volume is to include the "traditional" Border Trade milk (1 percent of NSW market milk requirements). This agreement is on the provision that no milk processor trades market milk interstate at a discount price. A copy of the press release from the Victorian Minister for Agriculture and Rural Affairs outlining the arrangement is attached.

- December 1987** Victorian Parliament passes an amendment to the Dairy Industry Act 1984 so that all milk used to manufacture market milk in Victoria must be purchased from the VDIA at the price determined by the VDIA. Midland Milk still trading discount milk to Sydney.
- 23 December 1987** Midland seeks and gains from the Federal Court injunction restraining the VDIA from imposing punitive measures as part of the new, tougher licence conditions. An additional requirement that the VDIA supply a fixed amount of milk at a discounted price was not granted.
- January 1988** Negotiation between NSW and Victoria continuing. Midland continuing to trade milk interstate.

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