

The Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600

by email to economics.sen@aph.gov.au

Dear Secretary, and through you members of the Committee

I wish to make a brief submission to your current inquiry on the *“impact on the Australian dairy industry supply chain of the recent decision by Coles supermarket (followed by Woolworths, Aldi and Franklins) to heavily discount the price of milk (to \$1 per litre) and other dairy products”*.

My submission addresses issues in all areas of reference other than (f). My central point is ***that current market conditions and policies undercut milk industry viability***. This is presented in brief comments and a series of specific points. *I have focussed on issues that appear generally overlooked*. My current submission must be short but I am very happy to expand on any comments or to provide supporting evidence for any points upon request.

My hope for your Committee is that your deliberations result in *a move away from what are, at best, “capricious” actions which heedlessly (we hope) transfer costs and risks to other parties and a move towards more viable enterprises and reduced industry risks*.

Australian industries need ongoing viability to be a realisable possibility, not a risky wish. Ignoring such things undercuts not just food quality and security, Our various trading positions and the different capitals upon which we all depend for our incomes and livelihoods need to be soundly based and sustainably developed in the fullest sense.

As the unfolding global crisis demonstrates, this is not a time to take such things for granted. We risk much when foolish short-term commercial practices dominate the development of our nation, its industries and our people. My concern, then, is that increasingly important, foundational issues may become lost in the processes of inquiry *and response*. Divisive winner–loser distractions have impeded progress in the past with essential common interests then overlooked. Strategies and thinking suiting particular interests have been promoted as being in the public interest for too long.

I would like to wish you well in your deliberations, and thank you for considering this submission.

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Position:

That current market conditions and policies undercut milk industry viability.

Australia has effectively no dairy industry strategy beyond “current trading in markets”. Immediate commercial policies can dominate in such a situation of inadequate public policy. Failures to adequately consider, let alone address, financial viability over time and the uses of capitals threaten not just individuals but the sector as a whole.

An industry heavily reliant on debt funding while achieving a minimal rate of return that is below the interest rate is going backwards. This is the current situation. Cheap milk may be obtainable for a time, but this will not last. Excessive price squeezes and the distortions they bring impoverish us all, sooner or later.

Farmers will seek to maintain adequate cash flows in the short term while hoping their capital positions become sustainable. If milk prices are unsustainably low then capital positions deteriorate unless offset by speculative factors (and balance sheet illusions). This is not a sensible basis for an industry providing a key food to Australians. A central question is “Why buy, run or finance a dairy farm when the revenues look uncertain or prices suggest minimal returns other than through land speculation?”

Milk processors and retailers will have their own funding costs and risk profiles which are enhanced by their ability to obtain equity funding and offshore loans at low interest rates. This funding asymmetry is another element that appears unaddressed in current considerations. It exists both between milk-supply sectors and between domestic and multinational enterprises.

The milk product mix and how various products are priced into the markets appears under-addressed in considerations. Milk has a variety of uses with different returns. Who captures these various returns and how is an important question, one which can significantly affect returns, risks and viability.

The Senate Committee has a wealth of materials available from current submissions and the reports of previous Inquiries. I intend using some of these in my further research and thank the Senate for making these easily available. I would like to wish members well in their endeavours in this Inquiry, one which has significance for not just the milk sectors but for Australian industries more generally in these uncertain times.

Specific points in support of these comments are offered on the next page. Again, I am very happy to expand on any comments or to provide supporting evidence for any points upon request.

Specific points

The deeper impacts of uncertain prices ultimately matter most. Financial returns from current activities of dairy farms can be considered in terms of rates of return, with or without capital appreciation. The situation is unclear but initial evidence suggests **that:**

viability is doubtful

1. reported rates of return are low for the dairying sector;
2. these may be unsustainably low;
3. the equity of farmers is currently high on average but this reflects some unsustainable imbalances in balance sheets and an aging of the farm cohort;
4. rising capital valuations have supported ongoing enterprise trading;
5. the sector is markedly exposed to any fall in capital valuations;
6. additional exposures arise from a raft of regulatory and environmental initiatives which appear to lack evaluations of effects on viability;
7. such things make sensible new entry difficult and present a significant barrier to feasible intergenerational change;

risks are considerable, unappreciated and, too often, needless

8. current financing arrangements are needlessly risky with the risks often unappreciated;
9. such risks are compounded by market plays by related parties, such as the “prices down *and* staying down” strategy of Coles;
10. in situations of interdependence such as those found in the milk supply chain naïve concepts of market competitiveness are manifestly inadequate;
11. interest rate rises on top of already historically high capital costs will squeeze many exposed farmers, many of who are likely to be “next generation”;
12. international conditions present significant unappreciated risks;

policy analyses, responses and impacts have been inadequate

13. past Senate reports show some good movement towards more informed analysis and a more adequate framework. This is very welcome from the public interest point of view;
14. such things are contrary to commercial interests and mainstream advisory positions which discount the above considerations (for others than themselves). This, in part, explains slow progress in needed reform;
15. proper incorporation into policy of the finding of past enquiries and those likely from the current one will require several shifts, including from “productivity” and naïve “competitiveness” analysis to considerations of profitability across the whole of the life of an asset or enterprise with attendant obligations;
16. it is, after all, sufficient profitability over time from sustainable activities that is both the common need of all parties in the milk supply chain (including consumers and financiers) and the basis of viable development in rural and urban Australia;
17. a lesson of the Global Financial Crisis is that we imperil much when we forget such things. Markets globally continue to reset around more realistic valuations of capital, risk and return. Australian industries and enterprises need refreshed development plans;
18. the Senate may need to augment its own existing research capability to accommodate more adequately the diversity of views on industry matters lest we fall further into a situation of collective unintelligence through overreliance on some favoured “mainstream” viewpoint; and
19. a more adequate academic dialogue needs to be supported by removing imposts and conventions that needlessly limit research in relevant areas.