305 Koroit/Point Fairy Road, Crossley VIC 3283

FURTHER SUBISSION BY FARMER POWER TO THE SENATE INQUIRY INTO THE AUSTRALIAN DAIRY INDUSTRY

Farmer Power welcomes the opportunity to make a further submission to the Senate Inquiry, to clarify its recommendations on various points raised in the hearings, based on our knowledge of the views of dairy farmers and the dynamics of the Australian dairy industry.

In particular we have been asked to explain in more detail how a 50c milk levy might work as a buffer against fluctuations in farmgate milk pricing, as a transition to a fairer and more reliable milk pricing regime. We have also been asked to comment on comparable price moderation mechanisms used in other dairy producing countries.

As a voluntary organisation our research resources are obviously more limited than those of the established dairy industry bodies, but we offer the following information and recommendations. We very much hope that the Senate is able to use this submission in formulating constructive solutions for the Australian dairy industry, to enable it to not only survive but also rebuild.

Pricing mechanisms applied in other dairy producing countries

Canada

Canada has the most regulated market, though it is currently subject to review. Since the 1970s dairy products have been subject to a national supply management system jointly managed by the Federal and Provincial Government, which sets farmgate milk prices, controls supply and limits imports. This has been described as the "three legged stool: if one of the legs is weak or breaks, buddy ends up under the cow." A floorprice for milk paid to the farmer is set on a regional basis, taking into consideration the cost of production, consumers' ability to pay and other economic conditions. In 2016 farmers receive around AUD70c per litre at the farmgate, but they are subject to a production quota (new farmers can buy quotas). There is also a floorprice for what processors can charge retailers. Other dairy products are subject to a similar floorprice, and for export products (only) this is linked to the world price. While there are complaints from consumers about the relatively high prices compared with the USA, the Dairy Farmers of Canada has pointed out that the lower US prices result from a significant subsidy paid to farmers. There are no government subsidies for farmers in Canada as under this system consumers pay for the full costs of dairy production. Some changes are being introduced for export products, with an agreement that export subsidies will be phased out by 2021, as will the practice of the Federal Government purchasing surplus production. However price regulation on domestic products seems likely to remain in place, and these are seen as essential to retaining a strong industry. Milk production appears to have grown steadily encouraged by growth in quotas.

The retail price to the consumer was around AUD$2 per litre in 2014. Despite relatively high prices for milk paid by consumers compared with the USA, a recent poll found that 81% of Canadians want to retain supply management, and a majority were prepared to pay even higher retail prices if necessary to maintain the industry.

References : www.agrifoodecon.ca; www.dairyfarmers.ca

USA

Direct subsidies have historically been paid to farmers as “farm income stabilisation” payments, amounting to a guaranteed floor price. In 2014 dairy production was subsidised by the government at around 31c per litre top up payment at the farmgate. At that time previous subsidy arrangements were replaced by a government funded Margin Protection Program for Dairy Producers which offers producers compensation when the farmgate price falls below a set level. Some of this insurance is free, but farmers can purchase additional cover. This insurance system has significantly increased the subsidies paid compared with previous programs, to over 50c per litre. A Dairy Product Donation Program was also introduced which requires the US Government to purchase dairy products for donation to food banks and other feeding programs when farmers’ margins fall. Consumers benefit from artificially low prices, but they ultimately pay the additional costs of the subsidies through taxes. Drinking milk retailed at around AUD $1.20 per litre in 2014, but was regarded as a “loss leader”, being sold at a loss by supermarkets to attract customers for other products.

In the USA, there has also been some encouragement given for farmers to invest in the dairy futures market, to maximise their economic benefits from the industry. Some agencies have suggested that this would be of benefit to Australian farmers. However at face value we do not see this as a useful strategy for farmers, as it has the potential to add to the current high level of uncertainty and risk. In any case, there would be very limited capacity to put funds into such investment schemes given the current state of the industry.

Reference: www.fsa.usda.gov/programs-and-services/Dairy-MPP/index

New Zealand

NZ exports 95% of its dairy production, and is the largest global dairy exporter. It is acknowledged to have one of the most deregulated markets in the world, so prices paid to farmers are heavily influenced by the global market. Subsidies to farmers were eliminated in 1984. Over time the payments made to NZ farmers have been similar to those paid to Australian dairy farmers (but note that their costs of production tend to be much lower due to climatic conditions). Over the last year this resulted in a drastic cut to the farmgate price, putting farmers under severe pressure and resulting in around 10% loss of production.

Within the domestic market, drinking milk was retailed at a minimum around AUD$1.70 per litre in 2014, and this dropped around 10% over the following year as the farmgate price dropped in response to the global market. The relatively high price is attributed to limited competition, with the market dominated by Fonterra and Goodman Fielder as well as two major supermarket chains. Also the NZ Government taxes food under its goods and services tax, unlike most other countries. The extra earnings from the relatively high retail price of milk is shared by the Government (27c per litre) and the processors/supermarkets, and do not appear to be passed on to the farmers.

Despite the claims of deregulation the NZ Government does invest in the dairy industry through joint ventures with dairy processors, one of which is the $80M "Transforming the Dairy Value Chain" program. Observers have previously commented that New Zealand and Australia are the only countries which treat free trade guidelines as mandatory. In the case of New Zealand, this can be attributed to the importance of its dairy export activities to the total economy. For Australia this also could have been the case, as production was on a par with New Zealand prior to deregulation, but sadly this is no longer the case.

Reference: http://dailysignal.com/2016/09/22/what-happened-when-new-zealand-got-rid-of-government-subsidies-for-farmers/; http://www.stuff.co.nz/business/77864733/Whats-all-this-crying-over-spilled-milk-New-Zealands-dairy-crisis-explained

UK

As in Australia, when the dairy industry was deregulated, UK farm prices went down but retail prices went up. Despite more recent buffering through EU subsidies (see below) this produced a similar crisis to that experienced in Australia. There was then militant action by farmers and their supporters, including an effective trolley protest where discounted supermarket milk was bought up by the trolley load and resold at a higher price in the carparks, with the profits donated to charity. Some farmers also herded cattle through supermarkets, and consumers presented petitions to Parliament. A Parliamentary Inquiry was held. The National Farmers Union helped to negotiate a partial resolution of the crisis. This has involved the major supermarkets (including Aldi) promising to pay a minimum price per litre for all milk sold in the domestic market in 2015, and this has been extended to other dairy products. The floorprice paid to processors was around AUD50c per litre at a time when the average farmgate milk price was around AUD 40c per litre, but the actual floorprice to farmers is not guaranteed by the processors. The arrangement is not seen as an effective solution, and further reform is being sought. Some new milk brands have been introduced which guarantee a top up payment of AUD20c per litre paid directly to farmers (eg Morrisons' Milk for Farmers range), but these have been much criticised as token gestures. Homebrand milk retails for around AUD$1 per litre, but it is claimed that this is a loss leader for the relevant supermarket chains.

The recent Parliamentary Inquiry found that much more protection needs to be given to dairy farmers, as price volatility and price suppression by supermarkets was driving farmers out of business. Recommendations included giving greater power to the Groceries Code Adjudicator, helping farmers form new associations for collective bargaining with processors, developing codes of conduct, and clearer product labelling.

Reference: https://petition.parliament.uk/petitions/105450; http://www.telegraph.co.uk/finance/newsbysector/retailandconsumer/11803503/Supermarkets-agree-to-set-new-minimum-price-for-milk-amid-mounting-pressure-to-give-farmers-; http://www.parliament.uk/business/committees/committees-a-z/commons-select/environment-food-and-rural-affairs-committee/news-parliament-2015/dairy-prices/

EU

The EU is the world's largest milk producer and removal of production quotas in 2015 exacerbated global gluts in some commodity areas (notably milk powders). Production increases were most marked in central and eastern Europe, stimulated by low feed costs and access to improved technology. Production is heavily subsidised, with agricultural and fisheries subsidies accounting for 40% of the EU budget. The largest subsidy under the Common Agricultural Policy is the Single Farm Payment, but there are additional subsidies for young farmers, small scale farmers, less favourable production areas etc. The EU also intervenes in the global market by purchasing products to hold in storage for price manipulation purposes, and there is a crisis fund for additional use. It is estimated that around 42% of dairy farmers' income is in the form of subsidies. Nonetheless EU dairy farmers have mounted significant protests against low farmgate prices, which have now fallen below the cost of production. Protests have included spilling milk over public places, truck blockades into major cities, etc. In response, some additional support packages have been introduced in recent months.

Irish farmers appear to have benefitted financially from their relatively strong negotiating position in relation to processors, as milk supply is generally organised there by farmer co-operatives.

The domestic retail price of milk varies between countries but is typically 10-50% higher than milk prices in the UK.

Reference: http://www.stuff.co.nz/business/farming/dairy/76978648/Feds-dairy-head-points-finger-at-EU-subsidies-for-dairy-price-fall

Proposed Australia dairy industry levy (interim measure)

In the transition to deregulation, a levy was imposed on all drinking milk sold into the domestic market, collected and redistributed by Dairy Australia, resulting in a farmgate top up price to all dairy farmers. This was abandoned in 2007, and in the following years farmgate milk price has become increasingly unstable. Farmer Power has suggested that this levy mechanism should be revived to soften the impact of the current crisis, as a temporary measure until more permanent solutions are developed. If a 50c levy was imposed on drinking milk and redistributed in full to all dairy farmers this would result in a top up at the farmgate which would be sufficient to ensure that the cost of production was met. As the legislation and regulations previously drafted could be revived, given the political will to do so, it would appear that this measure could be swiftly implemented to stem the exodus of farmers from the industry.

We note that others have suggested that a 20c levy would be more readily achievable. We point out that this would not be sufficient to enable farmers to meet their costs of production by the time it is redistributed to all farmers, and that there have been numerous consumer surveys indicating a willingness to pay an extra 50c.

In the long term a different pricing mechanism would be appropriate, ensuring that the increased margins achieved through the levy were not undermined by the processors or the supermarkets. This requires further consideration, with the statutory models used in Canada and the USA (based on a floorprice) offering possibilities. However a voluntary model such as has been negotiated in the UK does not appear to be effective.

Proposed dairy product labelling (longer term measure)

In Queensland the Katter Australia Party has tabled a Fair Milk Bill with apparent support from the Queensland Dairy Organisation. If passed this would introduce labelling of all milk products (not just drinking milk) to identify whether farmers have been paid a fair price. Under this system, milk processors could opt into the new labelling system, and there would be a twice yearly audit by the Queensland Dairy Accounting System and others. Having the label in place would give consumers some certainty that they are supporting farmers through their purchasing choices.

This proposal does not involve a redistribution system so would be of benefit only to those dairy processors supplying to the domestic market. However this may be the bulk of Australian farmers if production continues to fall. It would seem appropriate to consider this at the national level, as an alternative to a mandated floorprice, if complemented by other measures (see below).

Proposed commodity pricing indexation

It is suggested that as over 75% of production now caters for the domestic market, and the proportion of export production is continuing to fall, there is no longer any justification for farmgate prices to be indexed to the global market. In actual fact, fluctuations in pricing over the past decade appear to have resulted in Australian farmers being paid even less than if the global index had been used for pricing. There is much discretion in how commodity pricing indices are applied, made complex by the fact that there are a number of such indices, and that some dairy products are not subject to indexed commodity pricing at all. In addition, export advantages gained through favourable foreign exchange rates do not appear to have been passed on to farmers, while they appear to have been quickly penalised if the exchange rate fluctuations are unfavourable.

If those remaining dairy farmers producing for the export market were to be paid according to the global market, there would need to be accountable mechanisms for ensuring that they benefit from price rises as well as feeling the effects of any global fall. It does not appear that this will happen if left to the discretion of dairy processors, based on past experience. In addition to accurate and transparent indexing, an insurance scheme such as that applied in the US may be helpful in softening the impact of a depressed market. This could be a long term measure that replaces the temporary 50c levy. The insurance scheme would also benefit farmers supplying processors who did not subscribe to fair milk price labelling, so that the two measures would be fully complementary. It is suggested that the funds set aside for the current Dairy Industry Recovery Package (which are generally not being taken up by farmers) could be used to establish the insurance scheme. Additional funds could be raised from within the industry when global dairy prices rise above a benchmark level.

Mandatory code of conduct

Introducing price moderation needs to be complemented by removal of milk supply contracts which offer no protection of farmers from exploitation. At present contracts contain anti-competitive components which take money off farmers without justification. Farmers earnings are eroded by “loyalty provisions” (ie withheld payments), “penalty provisions” (effectively fines for not being able to supply milk due to circumstances beyond the farmer’s control), “loan repayments” (including capital and interest deduction from milk payments, even when no loan has been agreed to, or under undisclosed conditions of loans) and “privacy” requirements (preventing disclosure of what or how farmers re being paid). Contracts are commonly silent about the farmgate milk price (leaving this to periodic and discretionary “announcements”), so that financial obligations are all one sided, in favour of the processors. The legality of such contracts is highly questionable, but farmers do not have the resources or the bargaining power to challenge them.

Given the past behaviour of dairy processors in using these contracts when they clearly could have done otherwise, it is strongly argued by Farmer Power that any voluntary gestures by the processors to change their contacting practices will not be trusted by dairy farmers. Only a mandatory code of conduct will suffice, and this needs to be enforced by an independent ombudsman, with sufficient resources to investigate and resolve complaints from farmers. This should be fully funded by the processors, given that the present problems can be attributed to their behaviour.

This needs to be implemented with minimal delay. The ACCC has already pondered the contents of unfair milk supply contracts over the last six months. On this basis we consider it would be possible for the ACCC to draft a fair contract template within four weeks, and to then test it (with feedback supplied by farmers and processors) over a three month period before mandating its use. Other aspects of the Code of Conduct may take longer to develop.

Farmer Power would welcome the opportunity to contribute to the development of a Mandatory Code of Conduct for the Dairy Industry. This needs to be established as soon as possible, and should not wait for the outcome of the proposed ACCC Inquiry.

Rebuilding Australia's Dairy Industry

Despite warnings from Farmer Power and others, there has been no effective action by Commonwealth or State Governments to address the decline of Australia's dairy industry. As a result, production which has been in steady decline is now undergoing an even steeper fall, with younger farmers (ie the future of the industry) quitting in greatest numbers. It will take some time and effort to reverse this situation. The questions for Australian politicians are as follows.

(a) Do you want Australia to have a dairy industry that achieves its export potential, trading on its clean green image? or

(b) Do you want an industry that provides sufficient food for the domestic market? or

(c) Are you content to let New Zealand produce the dairy products that Australia consumes?

At present, the signs are that the major parties have adopted policies that will lead to scenario (c), either by design or default. It is clear that the priority for consumers is scenario (b) as a bare minimum. However the interests of the Australian economy would be best served by aiming for scenario (a).

We would strongly recommend that the Commonwealth Government works collaboratively with the States to produce a Dairy Industry Recovery Plan that will restore Australia's dairy production capacity. This requires restoring production on farm (which starts with paying a sustainable farmgate price for milk) as well as encouraging processors to pursue long term development strategies rather than maximising short term returns for their shareholders.

The current situation faced by the Murray Goulburn Co-operative has brought the problems of the industry into sharp focus. While it is not appropriate for us to articulate the failings of this company, the end results are a loss of milk suppliers, impending closure of production plants and loss of processing jobs. In this situation other milk processors have no need to increase payments or improve treatment of farmers, as previous suppliers to MG seek alternative supply contracts. Milk supply is therefore likely to continue to plummet until other processors are affected. A 25% fall in production will turn Australia into a net importer, and at that point (if not earlier) Fonterra may choose to supply the Australian market from its New Zealand base rather than from within Australia. Fonterra's withdrawal would mean that the remaining processors can continue to offer low prices and poor supply conditions until the industry collapses beyond repair.

This emerging scenario has been clear to Farmer Power for some time, which is why we have pleaded for Government intervention. However the established dairy industry bodies appear to be in denial, for whatever reason. We would urge that there should be no further delay in taking effective action to halt the current industry collapse, and to introduce measures for rebuilding milk supply. It will take three year period to reverse the current trend (based on the bovine reproductive cycle) so a ten year recovery timeline is called for, with a target of restoring production to pre-deregulation levels, and providing an environment for ongoing production increases.

Please note that if the first step in addressing the crisis was an immediate reintroduction of the levy on the price of drinking milk, this would actually assist in the survival of MG as it would enable its current suppliers to stay with the company. However this would need to be followed by clear strategies for improving the company's governance and commercial performance.

We note that there are pre-existing documents prepared by Dairy Australia and the United Dairyfamers of Victoria that purport to offer future vision or strategies for growing the Australian dairy industry. However if you examine these documents you will clearly see that they do not reflect the actual state of the industry, there are no strategies that are capable of implementation, and there is no assessment of achievements made. The dairy industry deserves much better than this. This needs to be led by the Commonwealth Government.

Farmer Power would welcome the opportunity to contribute to the development of a realistic whole-of-government Ten Year Australian Dairy Industry Recovery Plan.

Role of Dairy Australia

We have already expressed criticism of this organisation. We believe its governance is biased in favour of dairy processors, its value as a research agency is diminished (noting in particular its withdrawal of funding from the flagship Dairy Innovation Australia Ltd – DIAL, resulting in DIAL's closure), and its role in protecting the interests of dairy farmers is being ignored. Dairy Australia should have been front and centre in warning the Government about the current crisis, and proposing solutions. It has failed both the Government and Australia dairy farmers. In short, we believe Dairy Australia has lost its way. The level of compulsory financial contributions from farmers (around $8,000 per farm, currently totalling than $30M per annum) is exorbitant and unjustified, and the value for money delivered to Government is questionable. Our recommendations are as follows.

- There would be ample justification for completely defunding Dairy Australia and replacing it with a newly restructure organisation in conjunction with re-working the other dairy industry representative and peak industry bodies (see below).

- If a dairy industry levy is supported by the Government, it would be necessary for Dairy Australia to be retained as the administrative body in the short term.

- If the Government wishes to retain Dairy Australia in the longer term we would recommend that base funding is provided by the Government for the organisation to make the transition to one that receives voluntary rather than compulsory subscriptions from dairy farmers. This would be in line with most other industry bodies, and is consistent with a deregulated industry environment. It would provide the necessary incentives for much better governance and performance.

Reform of other industry peak bodies

We believe that a majority of dairy farmers have lost confidence in the Australian Dairy Farmers and the United Dairyfarmers of Victoria. However some other State based industry bodies appear to have good support. Given that subscriptions are optional, those that attract poor support from farmers are becoming more reliant on funding from supermarkets and dairy processors. It seems that some officials are using their roles as a pathway to a political career rather than putting the interests of farmers first. There is every justification for an overhaul of these representative structures, and in some countries where similar problems have arisen such reforms have been led by Government. In the absence of such intervention in Australia it is likely that dairy farmers will take action themselves. In the interim, the Government should be aware that the advice they are receiving from these organisations may not represent the views of dairy farmers, and may in fact be compromised. We recommend that State and Commonwealth Governments need to engage with farmers outside the established structures.

Another industry body is the Gardiner Foundation. This manages a fund of around $100M which was raised by Victorian dairy farmers through the sale of the various dairy brand names they had established, and its charter is to fund research that benefits Victorian dairy farmers. Some farmers believe that the governance of the Foundation is heavily influenced by the same inner circle that now controls Dairy Australia, and there is concern that the Foundation has started to fund projects that are of no benefit to Victorian dairy farmers. We would suggest that winding up the Foundation may be appropriate in the current industry circumstances, with the funds being handed back to Victorian dairy farmers as a one off cash payment (around $40,000 per farm) to assist them to rebuild. Alternatively, the funds could be channelled into new grants program that assists new/young farmers to secure a foothold in the industry. Consideration of these options should form part of the Industry Recovery Plan.