COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

# SENATE

## ECONOMICS REFERENCES COMMITTEE

**Reference: Impacts of supermarket price decisions on the dairy industry**

THURSDAY, 10 MARCH 2011

CANBERRA

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**SENATE ECONOMICS**

**REFERENCES COMMITTEE**

**Thursday, 10 March 2011**

**Members:** Senator Eggleston (Chair), Senator Hurley (Deputy Chair) and Senators Bushby, McGauran, Pratt and Xenophon

**Substitute members:** Senator O'Brien to replace Senator Pratt

**Participating members:** Senators Abetz, Adams, Back, Barnett, Bernardi, Bilyk, Birmingham, Mark Bishop, Boswell, Boyce, Brandis, Bob Brown, Carol Brown, Cameron, Cash, Colbeck, Coonan, Cormann, Crossin, Faulkner, Ferguson, Fielding, Fierravanti-Wells, Fifield, Fisher, Forshaw, Furner, Hanson-Young, Heffernan, Humphries, Hutchins, Johnston, Joyce, Kroger, Ludlam, Ian Macdonald, McEwen, Marshall, Mason, Milne, Minchin, Moore, Nash, O'Brien, Parry, Payne, Polley, Pratt, Ronaldson, Ryan, Scullion, Siewert, Stephens, Sterle, Troeth, Trood, Williams and Wortley

**Senators in attendance:** Senators Colbeck, Eggleston, Heffernan, Hurley, Milne, O'Brien, Ryan and Xenophon

**Terms of reference for the inquiry:**

To inquire into and report 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, with particular reference to:

(a) farm gate, wholesale and retail milk prices;

(b) the decrease in Australian production of milk from 11 billion litres in 2004 to 9 billion litres in 2011, of which only 25 per cent is drinking milk;

(c) whether such a price reduction is anti-competitive;

(d) the suitability of the framework contained in the Horticulture Code of Conduct to the Australian dairy industry;

(e) the recommendations of the 2010 Economics References Committee report, *Milking it for all it's worth—competition and pricing in the Australian dairy industry* and how these have progressed;

(f) the need for any legislative amendments; and

(g) any other related matters.

WITNESSES

**Committee met at 8.30 am**

**ARCHER, Mr Bradford John Henry, Principal Adviser, Infrastructure, Competition and Consumer Division, Department of the Treasury**

**BURCH, Mr John, Manager, Infrastructure, Competition and Consumer Division, Department of the Treasury**

**DEITZ, Mr Andrew, Manager, Infrastructure, Competition and Consumer Division, Department of the Treasury**

**WRITER, Mr Simon, Manager, Competition and Consumer Policy Division, Department of the Treasury**

**CHAIR (Senator Eggleston)—**I declare open the third hearing of the Senate Economics References Committee's inquiry into the impacts of supermarket price decisions on the dairy industry. On 10 February 2011 the Senate referred this inquiry to the committee for report by 15 April 2011. To date, the committee has received over 90 submissions, which are available on the website. A further public hearing will be held in Canberra at a later date. These are public proceedings, although the committee may determine or agree to request to have evidence heard in camera.

I remind all witnesses that in giving evidence to the committee they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee and such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence to a Senate committee. If a witness objects to answering a question, the witness should state the ground upon which the objection is taken and the committee will determine whether it will insist on an answer, having regard to the ground which is claimed. If the committee determines to insist on an answer, a witness may request that the answer be given in camera and such a request may of course also be made at any other time.

The Senate has resolved that departmental officers if present shall not be asked to give opinions on matters of policy and shall be given a reasonable opportunity to refer questions to superior officers or a minister. This resolution prohibits only asking for opinions on matters of policy and does not preclude questions asking for explanations of policies or factual questions about when and how policies were adopted.

I welcome the representatives from Treasury. Do you have an opening statement to make?

**Mr Archer—**No.

**CHAIR—**So we will go to questions.

**Senator RYAN—**I want to highlight a couple of elements of your submission and expand upon them in the context of the evidence we have heard in the last few days. I am not sure if you are aware of that evidence but feel free to say you are not if that is the case. We have had some discussion around the objectives of competition policy. Is it fair to characterise two of the objectives as economic efficiency and competition being used as a means to deliver the most efficient outcome for consumers?

**Mr Archer**—Yes, I think that is a fair characterisation of the objects of competition policy. Competition is not an end in itself and the benefits of competition are many. They include that it provides incentives for businesses to prepare their products at least cost, to innovate and to meet the desires of consumers. Producing goods at least cost is what we refer to as technical efficiency. Also the competitive process that engenders resources flowing to those parts of the economy where they are most highly valued is what we refer to as allocative efficiency, in economic textbook terms. There is also the concept of dynamic efficiency, which goes to that point about innovation over time and incentives for firms to innovate to gain a competitive advantage in the marketplace.

**Senator RYAN**—I wish you had been my economics lecturer. You were better than him in explaining some of those concepts. One of the things that has been discussed which you cover in your inquiry is the reintroduction of an anti-competitive price discrimination provision in the act. Listening to all the evidence, one of the fears I have about such a provision is that if we had an anti-competitive price discrimination provision reinserted, conscious of the fact that it was not utilised much over the term of its existence in the act, theoretically that could lead to higher prices for consumers as it effectively prohibits a greater degree of price discrimination. That is a possible outcome, isn't it, because your submission refers to that being a potential limitation on price flexibility?

**Mr Archer**—Yes, I think that is a reasonable interpretation of the position that we have put in the submission. The issue of a prohibition against price discrimination is one—as we have highlighted in the submission—that has been reviewed several times. I guess where we see the issue at is that there are strong arguments for believing that other provisions of the Competition and Consumer Act can deal with concerns around price discrimination and that a specific prohibition does raise risks that businesses will be constrained in their ability to offer potentially lower prices to consumers in some circumstances.

**Senator RYAN**—A provision like that would not necessarily only catch larger businesses which is the way it has been framed in some of the evidence here. It is possible that, whether it be in smaller geographic areas where a market is defined differently, it could catch the behaviour of small or medium businesses.

**Mr Archer**—I guess that would go to exactly how any provision is drafted in the law. But generally the competition provisions have economy-wide impact and so would apply equally to both large and small businesses, unless the provisions were drafted in a different way.

**Senator RYAN**—One of the things that has been mentioned in this context is the fact that Australia is one of the few comparable nations or developed economies that does not have such a provision. Your submission covers quite effectively the criticisms or commentary on that provision over a long period of time in Australia. Do you have any evidence or any comment on the operation of such provisions in other markets?

**Mr Archer**—I personally am not familiar with how those provisions have operated. I might ask my colleague Mr Deitz if he has a perspective on that.

**Mr Deitz**—I think it is fair to suggest that, while it can be present in some of the overseas jurisdictions, it is not necessarily a feature at enforcement level that is consistently utilised at this time. With respect to some of the evidence in terms of overseas jurisdictions, it is fair to suggest the trend is probably towards repeal of these provisions rather than the reinstatement or the continuation of them. In 2009 Canada repealed the provisions that it had for specific anti-competitive price discrimination.

There is the Robinson-Patman Act, from somewhere in the 1930s, in the US which has been recommended for appeal multiple times but that has not been given effect to. There is also in Europe a subsection under the abuse of dominance provisions—which are comparable to our section 46 for misuse of market power—which specifically talks about discriminatory terms between sellers and buyers as a form of abuse of dominance. But that in some senses reflects the characterisation of its treatment here in Australia which is that it is considered to be—and is treated as—a form of misuse of market power. So to some extent there are provisions overseas on the face of some statutes where it does exist but the extent to which it is treated differently here in Australia is probably not that great in practice.

**Senator RYAN**—Just to clarify, the direction of some is towards repeal and where it is not it is not a particularly active provision. Is that a fair characterisation?

**Mr Deitz**—I think that is fair to suggest.

**Senator RYAN**—One of the things that had me stumped, and which I asked National Foods about yesterday, was that we have had a number of the processors—and National Foods was one—be particularly critical of the behaviour of the major supermarket chains in demanding lower prices and the potential impact of that through the supply chain. One of them, I understand, supplies over 80 per cent of the very product they are complaining about to the supermarket chains. When I asked them, ‘Why do you do it then?’ they did not seem to have an answer. What concerns me, and I would be interested in any comment you have that might explain this behaviour, is that we have processors complaining about the behaviour of the supermarket chains but they are, firstly, under no compulsion to supply such a product—they voluntarily supply to Coles and Woolworths in this sense. Secondly, they have their own brands which they could make competitive with the product they are supplying against their own brands. Are there any other examples of this which might enlighten me as to why they might be able to complain on one hand and yet continue to supply on the other?

**Mr Archer**—When you say ‘examples’ do you mean in other industries?

**Senator RYAN**—In other industries. It strikes me as odd that we have got a supplier complaining about the damage to their own brand that their own supply is doing to a competitor.

**Mr Archer**—Certainly in retail drinking milk is not the only example of supermarket chains offering privately branded products. The more general question I think goes to, in a sense, the relative bargaining power of the supermarkets vis-à-vis the dairy processors. I do not have any particular insights into that. Provided that fresh drinking milk continues to be a product which consumers demand, and which there is strong demand for, I would have thought that dairy processors would retain some bargaining power in those negotiations with supermarkets—certainly the larger ones. The kind of issue that you are raising is one that has crossed our minds as well. I guess the challenge is to sort through the statements that have been made by the parties in the issue to try to sort out truth from something else.

**Senator RYAN**—Thank you.

**Senator HEFFERNAN**—Isn't the problem that the global position, due to modern travel, modern transport and modern communications, sovereign funds, multinationals, free trade agreements and a world trade organisation which is overpowering the capacity of a lot of countries to control their own sovereignty and destiny. Isn't it just with the milk guys simply market power? You win a contract with Coles and Woolies and you go home to the missus that night and you get drunk and say, 'Beauty, we have won the contract.' Three years later you want to slash your wrists and jump off the Gap because they have screwed the backside out of you. Isn't that the case?

**Mr Archer**—You have raised some very broad-ranging questions there. If I focus perhaps on the dairy industry—again it goes back to this question of relative bargaining power—there is a separate set of issues around whethere there are breaches of the Trade Practices Act which the ACCC has indicated that it is investigating. Coles in this case, if it wishes to continue to supply fresh drinking milk to its customers, has to ensure that it receives a supply of that product. That goes back to my earlier point that in those circumstances one would have envisaged that processors do have some bargaining power in response to propositions that Coles might put to them.

**Senator HEFFERNAN**—Can I just interrupt there. With great respect, they do not. In North Queensland—I do not know where you come from—they do not have that. The dairy farmers up there are either going to sell their cows or cart their milk to Darwin, because the only processor there has lost the contract to a bloke that gets it from southern Queensland. It is garbage to say that they have market power. The market power is in the consolidation of the retail—82 per cent of the prepackaged market, versus five of the top retailers in the US 40 per cent, five of the top retailers, for instance, in Canada 60 per cent. With the ACCC you might as well have talked to that wall yesterday as to them. The law is out of date; I mean, get with it. You spend too long buried in Treasury, I think—get out and have a look about.

**Mr Archer**—I am not sure of your question.

**Senator HEFFERNAN**—But you know what I mean.

**Senator COLBECK**—I think Senator Heffernan often makes comments which invite a response but do not necessarily—

**Senator HEFFERNAN**—Just throw the bait in the water.

**CHAIR**—I might just ask you one question. You keep on referring to the public demand for fresh milk. One of the propositions we have heard is that the era of fresh milk may end, as it has in the UK, in western Europe and in the EU, and all that will be available is UHT milk. In other words, in 10 years time the public demand for fresh milk may not be met at all. The history of this is—we are told—that Tesco, the advisers to Coles, carried out a similar exercise 10 years ago in the United Kingdom. Now the processors are out of the picture and the supermarkets are very largely selling UHT milk. Is that the future for Australia?

**Mr Archer**—It is difficult for me to predict where things might be in 10 years time. Certainly the supermarkets, on the face of it, appear in the context of the current debate to be making statements that they recognise that their customers demand and value the supply of fresh drinking milk. I do not know if that is right. I think that there is no reason to disbelieve that at the present time. That being the case, it would be an interesting strategy for a supermarket to attempt to steer things in a direction where they are not supplying that milk while others continue to do so. They could be taking themselves out of a market which continues to reflect customer demand.

More broadly, there are always influences acting in the economy which have an impact on the products and services that are being offered whether it is movements in the exchange rate, whether it is technological change or whether it is in changes in consumer preferences. It is difficult for me to predict within this market how all of those things might impact over a long period of time.

**CHAIR**—I understand that it is difficult to predict but we do have the other precedent of western Europe where similar events occurred. Perhaps that precedent is something that should be borne in mind.

**Senator COLBECK**—The conversation around relative bargaining power is a very interesting one and it is one that I have tortured myself with for a period of time. It has manifested itself in the dairy debate over a period of time. The last argument we had around dairy was with the farmers versus the processors and how they had some semblance of balance of power in that relationship. That was the inquiry, a bit over 12 months ago, during which this committee looked at National Foods and its relationship with dairy farmers in Tasmania in particular but it has spread. It is a vexing question because here you have—in that circumstance—a multinational company making a whole broad range of public statements.

I have to say I am a little perplexed by the comments that I have heard this morning about what the supermarkets say their objectives are versus what their objectives really might be. I am a bit concerned that some people are being seduced by the rhetoric of the supermarkets rather than their real motives. If you take Senator Eggleston’s comments—and I am not sure I am completely on the same wavelength with the UHT milk—the supermarkets clearly have an objective of capturing market share. We had a discussion with the ACCC yesterday when we talked about predatory behaviour and what the definitions are and the triggers for consideration of that.

It may be that they are trying to capture the milk supply chain, which was effectively what happened in the UK with Tesco. They now basically control the whole supply chain. I am concerned that we get seduced by what the supermarkets say. We received a letter from them a week or so ago which, quite frankly, was inconsistent and insulting to our intelligence, telling us how wonderful they were. How do we look behind what they are saying to what their real motives are and how do we try and provide that balance of market power? The other question I would ask you specifically is: how do you define the misuse of market power in this whole process?

**Mr Archer**—The first point I would make is that we are fully aware that the statements from the various stakeholders are from people who have vested interests and possibly hidden agendas. We understand that—

**Senator COLBECK**—Not necessarily hidden but agendas.

**Mr Archer**—Certainly we agree on that point. The question around how we ensure that there is appropriate balance in the market in terms of market power and how that might be used, I guess goes to, in a sense, why we have the Competition and Consumer Act and the provisions that are there. As I said, the ACCC is looking at how they might apply in this case, if at all. In terms of defining misuse of market power and the operation of that provision I might defer to my colleague to talk more about that.

**Mr Deitz**—Just to reiterate what Mr Archer has said, obviously in the first instance it is a matter for the ACCC to be investigating the actual conduct happening here by investigating the facts, determining from the evidence the extent to which there is market power with respect to the conduct that is happening and then forming a view as to whether or not there is a misuse. Having said that, I guess it comes back to some extent to the observations made by Senator Ryan and the response provided by Mr Archer, which is that the purpose of the law, anti-competition policy, is there to preserve efficiency, to promote efficient, vigorous, effective competition and to safeguard against anti-competitive behaviour.

**Senator COLBECK**—I understand that and I am quite happy to recognise that as a premise for this. But there are quite obvious imbalances in that power in different circumstances. You go back to the old western where there was the one company town, for example, and then someone else tried to start up a business in the town. I understand what we are trying to do in promoting competition and all those sorts of things, but the question is: how do you actually balance up the market power? I know we have provisions that say that the farmers can use collective bargaining and things of that nature. I have seen examples of that where it has worked; I have seen examples where it has not worked, and that comes back largely to the behaviour of the participants. But I am trying to define how we characterise misuse of market power, because that is one of the key things that people are talking about in this instance. You have two supermarkets that effectively control the retail sector. Everyone down the supply chain and some of their competitors, who I accept have vested interests, are complaining about the market power that they have in these sorts of circumstances. How do we characterise that as far as the law is concerned so that we can ensure that the balance is fair?

**Mr Archer**—Our submission points to a range of factors that are relevant to the consideration of the degree of competition in a particular market. That does include, but not exclusively, the degree of market share that participants have, but it also includes other factors, importantly barriers to entry that might exist in that market. We have seen in the retail sector Aldi introducing competition into the retailing sector and there is the prospect of other companies, such as Costco, coming in—they are in Melbourne.

I will just jump back to an earlier question which was: how do we go about understanding what is really going on here? Clearly the ACCC has information gathering powers in relation to the exercise of its responsibilities and administration of the act. There are avenues available to the government to inquire into particular markets where there is a concern that there might not be sufficient competition. Those relate to other provisions in the Competition and Consumer Act which do potentially grant the body conducting the inquiry quite extensive information gathering powers—and then if you want to add on section 46.

**Mr Deitz**—The only thing that I would add to that answer—and it perhaps goes in part to some of the points you have raised—is with respect to identifying whether or not someone has market power. The law does not prevent or prohibit anyone from holding market power so from time to time individual firms in different sectors of the economy may have that power.

**Senator COLBECK**—The issue is misuse of that power, isn't it?

**Mr Deitz**—That is right. You can have market power. It then becomes a question of: have you misused it? The way in which that is defined under the act is that, firstly, you have substantial market power—I am talking here with reference to section 46 obviously—and that you have taken advantage of that in some way, so we can establish a causal connection between the market power that you have and the action that you have undertaken and that that is for one of the three prescribed purposes set out in section 46. In some senses you can have market power, so the question that you need to be examining here is whether or not the conduct being engaged in is related to having market power and taking advantage of it for one of the prescribed purposes. As Mr Archer has pointed out, that is a matter primarily for the ACCC to investigate. There is the right of private action under part 4 as well but the ACCC has investigative tools to examine these things and ultimately they are matters for courts to determine.

**Senator COLBECK**—I do not want to criticise the ACCC in this context. They are constrained by the tools that they have and that is part of the discussion that we are having as part of this process. When we talked yesterday to one of the protagonists in this debate, National Foods—whom I thought would have been a key witness in the whole process as far as the ACCC is concerned—the ACCC had not even spoken to them. They have indicated they are investigating and they have spoken to Coles. We accept that and we appreciate the fact that there is a process going on there.

I come back to my point about being captured or seduced by what the key protagonist is saying in this particular circumstance. It was put to us that there is no evidence at this point in time that Coles is selling product below cost. Yet the only evidence that we have—and I accept that we do not have the detail of evidence that the ACCC might have—is that they are because that is the evidence Coles themselves have put on the public record. They said at a previous inquiry that their gross margin is 22 per cent. Within that gross margin are costs that the ACCC deemed to be part of their costs. They have reduced their prices by 23½ per cent, based on their own advertising. They have paid the suppliers an increase in price and we have determined that through both the public comments of Coles and through the processors. Yet they clearly indicate to me on the public record—based on that information—that they are selling below cost. Yet the ACCC, based only on conversations with Coles—as I can determine at the moment—are saying that there is no evidence of that. Yet they have not spoken to the suppliers who are clearly part of this whole dust-up.

That culmination of evidence starts to concern me as to how complete this process might be. I come back to this being captured or seduced by the big companies. I have seen examples of that. I am sure plenty of small businesses and players who are perceived to have less market power would make the same complaint in other arguments. In fact, I am sure Senator Heffernan, if I were to let him—which I will not—could cite several examples.

**CHAIR**—Senator Milne, are you on the line?

**Senator MILNE**—Yes. I want to ask one question of Treasury. I have just been waiting for my turn.

**CHAIR**—We know you are there now, so that is fine.

**Senator XENOPHON**—Your role is to advise the government on competition issues, is that correct?

**Mr Archer**—Yes.

**Senator XENOPHON**—And when you look at competition issues, one of the arguments is that consumers are getting cheap milk—I think that was reflected even in some of the comments made by the chairman of the ACCC recently on the Sky News business program. But do you also look at the longer term effects in terms of the impact on the supply chain, what it could do to the viability of an industry and what the impact could be if you actually had people going out of business as a result of what Woolworths itself acknowledges is unsustainable pricing practices?

**Mr Archer**—Yes, we do take a broader view than just simply looking at the short-term impact on prices in the marketplace.

**Senator XENOPHON**—Has there been an analysis of this broader view rather than the short-term impact, given the enormous disquiet in the Australian dairy industry about what has occurred recently?

**Mr Archer**—Obviously we are aware that this is a significant issue and it is one that we are examining—

**Senator XENOPHON**—Sorry, when you say you are examining that, what is the time frame for that examination and when will there be an outcome of that analysis?

**Mr Archer**—We are preparing advice in response to the demands or queries that we receive from the Treasury portfolio ministers.

**Senator XENOPHON**—Does that mean that you have actually been requested to look at the longer term impacts?

**Mr Archer**—Not specifically, no. I guess we face exactly the same difficulty that Senator Colbeck has raised in relation to the information that is available to us to conduct an analysis here. In that sense to date the information that we have looked at and that we have been able to comment on is the information that is available in essence in the public arena. That is where the role of the ACCC is an important one because they do have the powers to enforce the Competition and Consumer Act to obtain information that is not available to others. I would not want to overstate the extent of the analysis that we are conducting because, as I say, we are very reliant on the information that is in the public arena. There are also government agencies which have greater expertise in the dairy market—

**Senator XENOPHON**—Maybe my question was not clear enough. It was a direct question: you have a key role in advising the government on competition issues—correct?

**Mr Archer**—That is correct, Senator.

**Senator XENOPHON**—There is no question about that. I have asked you whether you have been asked to undertake an analysis specifically on the issue of this milk price discounting and the potential impact it could have on the Australian dairy industry, in other words, down the supply chain. Have any of your ministers asked you to conduct such an analysis?

**Mr Archer**—We have been asked to provide advice on the issues that are clearly in play at the moment.

**Senator XENOPHON**—So is that a yes? My specific question was: have you been asked to provide advice on the medium to longer term impacts of the milk price discounting that is currently underway and that Woolworths itself acknowledges is unsustainable?

**Mr Archer**—I would have to take on notice exactly how any requests for advice that we have received from ministers have been framed, because I cannot tell you today exactly what specifically those requests might have been.

**Senator XENOPHON**—Mr Archer, it is not a trick question.

**Mr Archer**—I understand that, but I cannot sit here and put my hand on my heart—

*Senator Heffernan interjecting*—

**Mr Archer**—In effect that is what I am saying because I do not know exactly how those requests have been framed. I am aware that we have done some work and we have prepared some advice, but I cannot tell you exactly how those questions have been framed.

**Senator XENOPHON**—Perhaps you could take that on notice. In terms of the time frame for that advice, given the constraints you have already referred to in terms of information gathering, we heard yesterday from the Milk Vendors Association who said that in two to three weeks some of their people could go to the wall. We have heard from the Queensland dairy farmers in particular and other dairy farmers around the country that they are already being affected with one company's supplier contracts because branded milk sales have gone down. That impacts on the level of income they get because they slip to tier 2 more than tier 1. There is some urgency here. Can you indicate how long this analysis will take and what the time frame is for a release of that analysis to the ministers who have requested it or to government in relation to this?

**Mr Archer**—That partly goes to the question of what we have been asked to do.

**Senator XENOPHON**—Which you cannot tell us at this stage.

**Mr Archer—**I cannot. Clearly this is an issue which the government is paying attention to and it is mindful of the concerns that you have raised in relation to the urgency.

**Senator HEFFERNAN—**But you don't know what you have been asked to do.

**Mr Archer—**What I am saying is I cannot tell you exactly what requests we have received. I would not want to mislead the committee by offering up an answer which is not correct.

**Senator HEFFERNAN—**So at this point in time all you have is a bit of circle work and a bucket of custard as an outcome because you do not know what the input is.

**CHAIR—**I do not know what that question means.

**Senator HEFFERNAN—**It just means bureaucratic gobbledegook.

**Senator XENOPHON—**One of the complaints that has been made—and I think it has been raised—is that there are some people that are reluctant to speak out because Coles and Woolworths have such a dominant share in the marketplace. Is that a factor that you consider, given that we have two players in the supply chain who have so much market power? Is that a factor that is considered in terms of framing policy? There are people who are reluctant to speak out on this issue, notwithstanding this is a Senate committee, because they say it would affect their careers and their livelihoods.

**Mr Archer—**That is really a matter for those people who feel that they are inhibited.

**Senator XENOPHON—**Is it a function of market power though?

**Mr Archer—**First of all, I would have thought that there are avenues for them to provide information to the committee and to the ACCC in confidence so that the information can be taken into account and reflected in relevant deliberations. I would accept that there may be participants in the industry who do feel that way. I would not necessarily dispute that.

**Senator XENOPHON—**But there is the issue of the level of market share the two key players, Coles and Woolworths, have. Is that a factor that frames any advice, in terms of whether the extent of that market power is desirable in competition terms and whether there ought to be some countervailing policy measures to deal with that level of market power?

**Mr Archer—**I would have thought that to be at the very heart of the issue. That is the issue that we are looking at really, isn't it?

**Senator MILNE—**I want to follow up from Senator Xenophon. I note in Treasury's submission you say:

Governments also concern themselves with the attainment of other policy objectives, including consumer welfare and income distribution.

That is the bias that I see throughout your whole submission, whereas industry wellbeing or productivity does not seem to be one of the concerns you identify. I am interested in an explanation as to why you admit that sometimes there is a requirement to intervene to correct market failure and also that competition policy is secondary to other objectives, and governments concern themselves with consumer welfare and income distribution. Why is your bias throughout this whole submission about cheap prices for consumers being a net positive without considering that the impacts on industry might be a net long-term disbenefit?

**Mr Archer**—If that is the impression our submission has created then I think that is unfortunate. All the factors that you have raised there we would not see as being mutually exclusive but rather more mutually reinforcing. One of the aims of competition policy is to improve productivity and to get better performance from industry. It is about promoting consumer welfare. I said in my earlier remarks that competition policy is not about pursuing competition for its own sake. That is reflected in the law and in the policy statements that have been made by governments that what we are really interested in is the public interest in the end—

**Senator MILNE**—But if I can interrupt you there, yes, we are interested in the public benefit but you specifically list consumer welfare and income distribution as other matters government might concern itself with. You also say in your submission that the recent price reduction for drinking milk may generally be viewed as a short-term net positive outcome for consumers. Then you go on to say:

It is less clear whether any long term negative consequences may arise, and if they do, whether those negative consequences would outweigh the net community benefits.

One of the negative consequences could be that we end up not producing fresh milk in Australia and that we import milk, or that milk is produced in one or two centres for long-life milk, as Senator Eggleston said, and that there is no fresh milk in the market. Would you consider, if you could buy cheap UHT milk and it was readily available across Australia, that that is a net community benefit of national competition policy and your current arrangements?

**Mr Archer**—I am not sure that I am best placed to speak here for what would be in the public interest in terms of the milk products which are available to consumers. What we are aiming for is a well-functioning dairy market where consumer preferences are reflected in the products that are being offered by producers. So I guess if it were the case that consumers continued to have a preference for fresh drinking milk the market should be working to provide that.

**Senator MILNE**—Yes, but that is the point I am making to you and that everybody is trying to get through here. You are saying it is in the interests of the nation to have a well-functioning dairy sector, but the bias is consumer welfare and income distribution—and that seems to be always defined as a cheap product to the consumer is the net positive benefit. What I am saying is that there does not seem to be any policy consideration of what is the long-term benefit of having a functioning industry which provides fresh milk. Is Treasury actually considering that, as Senator Xenophon asked a moment ago, in your consideration of these policy contexts? Let me put it this way: would Treasury regard it as market failure if there ceased to be a fresh milk market in Australia?

**Mr Archer**—I feel that my previous comments went directly to that question. You referred to our submission. I think our submission stands, which is that it is clear that there has been a short-term price impact in the market and the submission states that. The submission notes that the longer term impacts are uncertain. One of those uncertainties, which you are identifying, is the eventuality that there is no longer fresh drinking milk supplied in Australia. So that is obviously a large uncertainty. It is not that we are ignoring the impact; it is the fact that it is uncertain. Again, we, like the committee, are working to understand what is happening in the market and what the likely consequences are.

**Senator MILNE—**But how can you understand that if you are not taking into account those other policy settings beyond just consumer welfare and income distribution? If that is your view, why are you posing the question whether any long-term negative consequences—and that of course means no fresh milk in Australia or a loss of dairy farmers out of the industry—would outweigh the net community benefit? What is the net community benefit of having no fresh milk available in Australia?

**Mr Archer—**I am concerned that I am going around in circles, so that I am not being specifically helpful—

**Senator MILNE—**Because we are trying to get answers from you about what else you are taking into account beyond cheap milk.

**Mr Archer—**The submission talks about consumer welfare and you have noted income distribution. It is not an exhaustive list of the factors that are relevant in considering competition policy. But consumer welfare also goes beyond simply the short-term price that is available to consumers in the market at a given point in time. It goes back to my earlier comment about consumer preferences. If consumer preferences are that there is fresh drinking milk available for them to purchase, then a well-functioning market will deliver that product, hopefully efficiently and at an efficient price. I am not sure how else to respond to your question.

**Senator MILNE—**I would put to you that there is not a well-functioning market because it is an unsustainable price that the milk is being offered at. But clearly you get the point. We want to see what other government objectives are in delivering policy outcomes.

**Senator O'BRIEN—**Perhaps I will begin with a comment to which I would invite your view. You note in your submission that the ACCC has noted that in relation to milk it is satisfied that the number of dairy processors available in Australia result in a workably competitive market. Is it not also true that the ACCC has had a direct hand in determining, through control of takeovers, just how many processors there are? Do you think it is likely that it would note its own failure if there was not adequate competition? That might be a bit rhetorical. I do not really expect you to answer that, because I think it is a bit self-evident that if the ACCC decides how many processors there are by ruling over which acquisitions take place then it has effectively decided how many processors in the end there are and it is approving its own decision. In terms of the previous section 49, you usefully provide some footnotes in relation to Cool and Sons and O'Brien Glass Industries. Is it not the case that although the provision was not used very often, if at all, by a regulator that it remained a useful provision for business to protect itself? Does not that case prove it?

**Mr Archer—**We did discuss earlier whether that specific provision really added to what in effect other provisions of the Competition and Consumer Act already achieve. I think in that case—and I stand to be corrected—it was found that not only section 49 was breached but at the same time section 47, so in effect there is the possibility that section 47 might have been sufficient to address the behaviour in that case.

**Senator O’BRIEN**—It might be. It therefore follows that it is not sufficient to deter what some suggest is an abuse of market power by major supermarkets at the moment in the way that they, having such a command of the retail sector, can drive the price of a good down to suit their business needs rather than the overall needs of the industry that is servicing them.

**Mr Deitz**—If I could make an observation, with all of these provisions of the act it is obviously a balancing exercise. Certainly, with respect to the Cool and Sons case that you have pointed to, it is not clear the extent to which, if section 49 had not existed at the time, section 46 or something else might have been added to a case. With respect to section 47, I do not think that is something we can particularly answer definitively. But there is always a balancing exercise with respect to these provisions. What we have seen over time, in the examination within this country, successive reviews pointing to that, on balance, the application of the provisions and its effect on the broader economy have been, in their view, overwhelmingly negative. So while it has been acknowledged and noted by one committee—the 1997 House of Representatives committee—that it considered that there might have been a slight decline—‘weakening’ I think is its word—of the protection for small business, the overwhelming view of committees has been that the rest of the deterrence effect was overwhelmingly against conduct which was pro-efficient and in the interests of consumers and the Australian economy more generally. So on balance, with all of these provisions, it is a question of deterrence and benefits.

**Senator O’BRIEN**—One wonders what that 1997 committee would have done had they before them details of how the market has developed in the context of a substantial deregulation of the dairy industry and what has arguably become, which was actually predicted by the head of Woolworths at the time, a major opportunity for the retail sector to have a major influence on price in that sector. As I recall the commentary at the time, I think it was the chief executive of Woolworths who, when deregulation was announced, said that that became a major opportunity for the retailers. And history has shown that they took that with both hands in a way that is causing some concern.

Let me also put another proposition to you because competition is an interesting thing. Is it arguable that, where a retailer has the power to operate without a profit in one sector and subsidise the profit in another sector of its business, it can put pressure on the industry servicing the non-profit sector of its business to that industry’s detriment? Is that fair competition?

**Mr Deitz**—The extent to which it constitutes a misuse of market power, if it were that, then it is capable of being dealt with under section 46. If it is not a misuse of market power and it is not having those consequences that you identify, then it is not unusual to see cross-subsidisation within markets.

**Senator HEFFERNAN**—And then obviously the cows end up in the saleyards.

**Senator O’BRIEN**—That may or may not be the case; I do not know that we can add that sort of value to the question that I asked. I guess the proposition is: if we were not looking at section 49 do we need to be looking at other provisions of the act to further define provisions which might lead to a remedy in these circumstances?

**Mr Deitz**—I think it is relevant to ask the question, as each of these previous reviews have, whether or not the existing provisions of the act do that job. Again, with reference to the observations that we have been discussing in relation to the 1997 House of Representatives committee, there have been significant changes to section 46, for example, since that time. So you would need to conduct that examination or ask that question with reference to the law as it currently stands and the case history as it has evolved since that time.

**Senator O'BRIEN**—So in relation to the other area of the legislation which might be used to address the deficiencies—as we might see it—in the power relationship, the collective bargaining provisions have been the subject of some tinkering. Is there any reason why this committee should not be looking at further deregulating the dairy industry participants' power to collectively bargain in response to a very powerful sector that they are supplying?

**Mr Archer**—When you say the dairy industry, that could be the farmers or it could be—

**Senator O'BRIEN**—I mean the farm sector.

**Mr Archer**—I understand that the ACCC touched on this yesterday. My understanding is that dairy farmers have already received authorisation, from the ACCC, pretty much right across the country to collectively bargain—

**Senator O'BRIEN**—We have evidence that the ACCC has knocked some back.

**Mr Archer**—I am not across the details but it does suggest that, if it is appropriately framed, the ACCC will grant an authorisation.

**Senator O'BRIEN**—What I am saying is: why should they need ACCC approval in every case to have the right to collectively bargain?

**Mr Archer**—I think the answer to that is that collective bargaining can be used in an anti-competitive manner. The presumption is that the negative impacts of collective bargaining might prevail.

**Senator O'BRIEN**—I understand that. The point is that you could argue that the anti-competitive nature of the power of the supermarkets is a difficulty but getting to that point means a long period of going through the courts. The ability of individual dairy farmers to do that may be severely limited.

**Senator HEFFERNAN**—Impossible.

**Mr Archer**—I must admit I do not have a detailed understanding of the collective bargaining arrangements currently in place—

**Senator O'BRIEN**—Fair enough.

**Mr Archer—**or the circumstances in which the ACCC might have refused to authorise a collective bargaining proposition. From listening yesterday to the ACCC, I think they indicated that they felt there was scope for greater use of collective bargaining in this industry. It does seem like something that the industry could consider exploring.

**Senator O'BRIEN—**We might need to think about deregulating the collective bargaining powers as well.

**Senator HEFFERNAN—**Are you familiar with what happened in North Queensland? Just say yes or no.

**Mr Archer—**Only to the extent that you referred to it earlier today.

**Senator HEFFERNAN—**Say that again?

**Mr Archer—**Only to the extent that you referred to what was happening there earlier today. I do not know if that is what you are referring to.

**Senator HEFFERNAN—**Yes. The difficulty in Northern Queensland is that the local dairy farmers were tied to National Foods and the local market, as DAFF point out, is a different market to the manufacturing market. They lost the contract to Parmalat, who source from southern Queensland, so it would not matter how much the blokes up north collectively bargained, the outcome is either to shut the mill or to cart it to Darwin. It is garbage.

**CHAIR—**Thank you for that point.

**Senator HEFFERNAN—**Can I ask a question on notice?

**CHAIR—**You can certainly put questions on notice.

**Senator COLBECK—**I just want to go back to the point that Senator Milne was raising before about references in your submission to income distribution and consumer welfare. The circumstance that exists in a lot of places but also has the potential to be exacerbated—based on evidence we received yesterday—is the differential that is being created in the access to a competitively priced product, by virtue of the supermarkets having the power to obtain or supply milk at this reduced rate versus smaller operators in the system who are more likely to be in small regional areas. That adds to the disparity between the cost of living in major metropolitan areas and there. People like Senator Ryan live in the cities, where it is not an issue at all; they can get access to these major supermarkets. How does that fit within the policy consideration of the sorts of things that Senator Milne was talking about—the circumstance of consumer welfare and income distribution—if, by virtue of the use of the market power that the supermarkets effectively have, they are creating a two-tier economy in respect of access to those goods?

**Mr Archer—**Those are legitimate considerations and ones that government can quite appropriately take into account in framing its policies in this area. Those issues are not directly identified or recognised in the Competition and Consumer Act provisions. If there is conduct that is having a broader community impact which is of concern to government, government can respond through other policies.

**Senator COLBECK—**That is where we come back to your role as an advisor to government which has been discussed by Senator Xenophon. What sorts of mechanisms are there available to actually deal with that? That becomes part of this whole equation, doesn't it?

**Mr Archer—**Yes, it does.

**Senator COLBECK—**You have answered the second part of my question but not the first part.

**Mr Archer—**The question of what other mechanisms are available?

**Senator COLBECK—**Yes.

**Mr Archer—**I would imagine there are a range of potential policy responses to recognise disadvantages that might be regarded as existing in regional centres. Indeed, there are probably policies in place which do that already. I must admit I have not given much thought to what they might be but the government has expenditure powers and taxation powers, and they could be brought to bear on the problem. But in terms of specific policy remedies, I do not have anything off the top of my head to offer to you today.

**Senator COLBECK—**But that is also the point of this inquiry. We are looking at what options and possibilities and remedies there might be. One of the reasons we have you before us is to discuss those sorts of things with you. I understand that as a government agency you have responsibilities to government but I still think it is legitimate for us to ask you to give some consideration to those sorts of policy areas too, because it is part of our deliberation as a committee of the parliament.

**Mr Archer—**I think part of the difficulty here—and I am not really trying to dodge the question—is that we are still trying to understand exactly what is happening in these markets and what the likely long-term consequences are. There is some difficulty in attempting to frame policy responses before you understand where and exactly what those problems might be and what those effects are.

**Senator COLBECK—**Hopefully our deliberations can help you and then you might be able to help us.

**Senator RYAN—**I want to go to the issue that Senator Milne talked about—consumer welfare—and how that is considered. A number of witnesses have said—it seems to have been a general consensus—that because of the cost of transport and other things, there is unlikely to be importation of fresh milk into Australia, as has happened in Europe—as opposed to manufactured milk products, which are obviously more transportable. It is fair to say that consumers are free to pay more for a fresh milk product, isn't it? At the moment fresh milk costs more than UHT and that market signal plays a critical role in maintaining access to fresh milk in places where it might be more expensive to provide. That is just part of the market settling process, isn't it?

**Mr Archer—**Yes.

**Senator RYAN**—So in essence the welfare of consumers is in their own hands. If fresh milk access is at risk because of unsustainable pricing in part of Australia—as we understand it there are multiple brands on offer, some more expensive than others—consumers can determine their own welfare simply through what they purchase at the store.

**Mr Archer**—Yes, I would agree with that. There is some degree of consumer sovereignty here and consumers can exercise choice.

**CHAIR**—If there are pressing issues left for Treasury, please ask them. Otherwise we can put questions on notice for Treasury to provide written replies to.

**Senator HEFFERNAN**—Briefly, has Treasury been alerted to the fact that while milk is on the table at the moment, bread is to follow and a whole range of other things?

**Mr Archer**—We are aware of media reports that at least one supermarket might be discounting in relation to other privately labelled products.

**Senator HEFFERNAN**—But they have already negotiated. They are not going to put it on the table yet because of the fuss over this. With that in the background, are you too dry an organisation to give consideration to the terms of reference which Senator Milne is familiar with: how do we in the future produce food that is affordable to the consumer? That means, do we have to reconfigure the household budget and put more of it towards the food in the longer term, from an environment that is sustainable and a farmer that is viable? We have to do that against the background of losing the sense of sovereignty globally and free trade agreements, modern communications and non-market currencies. The tariff thing is out of date now. Because of the fluctuations in the currency, tariff is meaningless.

Have you got a concept? I know you are a dry organisation. You allegedly give advice to the government and whoever, but I hope it is better than the advice of this morning, with great respect. Is it something you should get your mind around against the background of what is the planet these days, what is sovereignty, coping with the euro—the whole thing? How in the hell, in the long term, do we produce food that is affordable to the consumer—you cannot blame the consumer for wanting his tucker as cheap as he can get it—from an environment that will sustain it, given the global food basket is going to double by 2050 and by 2070 China is going to have to feed half of its population from someone else’s resources? How do we do that and have a farmer who is viable—who, in this case, it pays to get out of bed and keep milking the cows instead of selling them and retiring to the coast?

**CHAIR**—Thank you. Those are very broad questions.

**Senator HEFFERNAN**—Yes, but it is a sense of the whole problem.

**CHAIR**—I know but I am not sure they can answer it.

**Senator HEFFERNAN**—I am sure they cannot here and I do not expect them to.

**Senator XENOPHON**—Can I ask a couple of questions on notice?

**CHAIR—**You can put questions on notice, but we really are drawing to the end of our time. Do you have a short answer to the question of Senator Heffernan?

**Senator HEFFERNAN—**I do not want it answered. I want a written response.

**CHAIR—**You might want to provide us with some broad thoughts on it in writing.

**Senator XENOPHON—**Very quickly, on notice, can you provide in writing your view of what below cost is and what areas that would apply to? Is it below cost at a national level, at a state level or at a regional level? I cannot understand how Coles can get milk at the price they are selling it for at a place like Darwin or Kununurra, for instance. Do you look at those regional or sub-regional markets? Also, is there an inherent tension in the Coles advertising campaign of 'down, down and staying down'? What does that mean? Does it mean for a week, a month or a year? How does that work in with the whole issue of predatory pricing? If it is selling below cost in some markets does that then impact on the whole issue of predatory pricing under the competition and consumer laws?

**Mr Archer—**We will take that on notice.

**CHAIR—**If other senators have questions on notice, we will forward them to the Treasurer. I thank Treasury for being here this morning. We have gone a bit over time but it has been a useful discussion.

[9.37 am]

**MORRIS, Mr Paul, Deputy Executive Director, Australian Bureau of Agricultural and Resource Economics and Sciences**

**MURNANE, Mr Simon, General Manager, Livestock Industries and Animal Welfare Branch, Agricultural Productivity, Department of Agriculture, Fisheries and Forestry**

**CHAIR**—Welcome. You are circulating an opening statement. Do you want to provide a short summary of it to highlight the main points?

**Mr Morris—**We have circulated a short statement that I will perhaps briefly comment on. Firstly, our department is responsible for providing policy advice to the minister on issues affecting the dairy industry and, through ABARES, for providing research and advice to the government and other decision makers. We talk in our submission about the structural changes that have occurred in the dairy industry and the impacts of that in terms of farm numbers and numbers of cows and production, over time. We talk a bit in the submission also about the deregulation of the milk market and what that has meant for prices of milk in the farm, processor and retail levels—in particular, that they are determined by competitive forces. We also talk about some of the factors that are likely to drive and influence farm gate milk prices.

We talk about three things in particular in respect to the current situation. Firstly, there is uncertainty as to how long the supermarkets will maintain the lower prices; secondly, it will also depend on how milk processors react in terms of their pricing for branded milk and, thirdly, there are regional differences—this committee has talked about this as well—in terms of impacts being different in different parts of Australia. In particular, we differentiate between the northern and southern markets.

The submission also contains information that may be of interest to the committee in terms of codes of conduct which exist for the horticulture and for the produce and grocery sectors. I believe that is part of the committee's terms of reference so we thought that information may be useful to you. In summary, that concludes our opening statement.

**CHAIR—**First of all, can we accept this document as a tabled document so that it can be included in Hansard?

**Senator O'BRIEN—**So moved.

**CHAIR—**Thank you. I will ask you an opening question. What dairy subsidies are currently in place in other countries? Are they temporary or permanent and has the department done any work on the effect of similar or such subsidies on the Australian dairy industry?

**Mr Morris**—I think it is fair to say that internationally the dairy market is subject to quite a range of subsidies. It is well known that there are high levels of subsidies in Europe, Japan, the United States and Canada, for example. There is a range of measures that apply in those markets which influence the domestic price in those markets and can flow on to international markets.

We are also aware that at times both the European Union and the United States apply export subsidies to milk products, although they vary depending on international prices at the time. There has been a range of analysis of those dairy subsidies over time and their impact on global markets. If the committee would like it, I am sure we can find past ABARES reports which we could give you the references to, on notice.

**CHAIR**—We would appreciate that. Is there any analogous situation to what is happening now in Australia that you can draw upon? We have been told that a similar series of events occurred about a decade ago in the United Kingdom, where the price of milk in supermarkets was dropped considerably. The processors have now been taken out of the supply chain and the supermarkets are buying directly from the producers. Is that something you would care to comment on or provide further information about?

**Mr Morris**—I am sorry. I do not have any detail on the particular situation that occurred in the UK. I do not know whether my colleague has any information on that.

**Mr Murnane**—No, similarly, we do not have detailed analysis of what happened in the UK.

**CHAIR**—You talked about European Union subsidies, and farm subsidies in general are very common in the EU, but we have also been told that in some countries like France the amount of fresh milk available in supermarkets is very low and that it is UHT milk. Is that something you could provide some more information about in terms of the availability of fresh milk throughout the EU and what impacts subsidies have had on its availability or lack of availability? What differences are there with the European Union structure?

**Mr Morris**—We heard the committee ask this question to ACCC yesterday so we had a bit of notice that the question might be asked of us today. We had a look at what we have available and we did not have anything specifically on it but we did have a look overnight at other data and information that may be available on that question. To be frank, it is quite mixed as to the information that is available. I should caveat my response by saying that we are not quite sure exactly how reliable some of it is. On the indication of the information that we were able to find overnight, it appears that the percentage of consumption of UHT milk in various markets in Europe varies quite widely. As you mentioned, in France around 95 per cent of drinking milk consumed is UHT milk. By comparison, in the UK it is less than 10 per cent, so you get quite a wide variation.

In looking at some of the factors that might be driving that variation, it seems that consumer preferences might be playing quite a significant part in it. We had a quick look at the drinking milk consumption per capita, the per person consumption of drinking milk by market in Europe. There was a tendency for those markets with a high level of per capita consumption of milk to also have a very low consumption of UHT milk. Countries like Finland, Sweden, Ireland, the Netherlands, Norway and United Kingdom all have relatively high levels of per capita milk consumption and also very low levels—below 20 per cent—consumption of UHT milk.

Once you get below those countries to lower levels of per capita consumption, you get a mixed picture. Some countries below that level have very high UHT consumption and some countries have very low consumption. For example, France, which we mentioned, has quite high consumption of UHT milk but moderate consumption per capita of milk. Greece has a very low consumption of UHT milk and a fairly moderate consumption of milk per capita. There is not a clear relationship other than for the high milk consumers who seem to prefer not to have UHT milk. It would be a similar situation, I think, in Australia where we have relatively high per capita milk consumption of over 100 litres per person per year and relatively low UHT consumption.

**CHAIR**—Thank you for that answer. That is very useful information.

**Senator HURLEY**—There has been some suggestion during our inquiry that the supermarkets, the retail chains, would like to push people into UHT because it is easier for them. Were you able to get any information for those countries—and I am told that Germany was one of them—where there is a high UHT consumption? Was that due to market pressure or just consumer preference?

**Mr Morris**—We do not have detailed information on that. In terms of general dairy policies, they apply across the EU so it seems unlikely that that is a factor. But there could be influences of retail sector in that but it is unclear from the information we have. The information we have on Germany is that about 65 per cent of their consumption is UHT milk and they are in the moderate to lower end of the range of milk consumption per person. They seem to fit that general hypothesis, I suppose, that I put that it could be related to heavy milk consumption where countries seem to prefer not to have UHT milk.

**Senator HURLEY**—Yes. It is interesting that in the UK where they are influenced by Tesco, for example—which, we are told, are influencing Coles—that it is not a high consumption. I have another question. We have been talking about people moving into generic milk because of the price. In terms of UHT milk, the table I have got, which comes from Australian Dairy Farmers, says that UHT private label is $1.15 litre, so branded milk is actually below that. Does UHT more closely reflect the international price of milk?

**Mr Morris**—I think that it is fair to say that in parts of Australia, at least, the milk price is very much dependent on international prices, and that is generally not just for UHT but more for manufactured milk product. But in Victoria and southern New South Wales, and Tasmania to a degree, which are quite large suppliers of milk into the manufacturing sector for the international market, the price is very much dependent on what happens internationally, and that feeds through into the market fresh milk price and, I would assume, also into the UHT price. But because UHT milk consumption in Australia is a relatively small proportion of the overall market, we do not tend to do a lot of analysis on that particular sector on its own.

**Senator HURLEY**—Your submission says:

In Victoria and Tasmania ... the price paid to farmers for market milk will be closely linked to the price received by farmers for selling milk to dairy product manufacturers.

So, for Victoria and Tasmania anyway, there is no reason for farmers to sell their fresh milk at anything lower than that international price.

**Mr Morris**—That is correct. That is what we say in the submission: there is actually a floor placed on the price, at least in the southern markets, as a result of the fact that they sell a very large proportion—we have a graph showing the proportions for different states—to the manufacturers versus the market milk sectors. It seems that the price is very much set by the international price, which sets a floor on the degree to which prices could be lowered. Naturally there would be more product directed to the international market if the prices were lowered too far.

**Senator HURLEY—**So if people are making money at the existing price then, if worst comes to worst, they just sell more milk into the manufacturing and export markets.

**Mr Morris**—Certainly for those markets, that would seem to be the case. I think it is worth remembering that Australia is the third or fourth largest dairy product exporter in the world. So, in terms of our international position we are highly cost efficient, highly competitive internationally. That places us in a strong position internationally in terms of where we sit on the cost curve.

**Senator HURLEY—**So there could be more of an adjustment in the market if things continue but it is difficult to see anything going below that one dollar a litre price. Possibly the pressure will be to push the price up on that.

**Mr Morris**—It depends. In the submission we look at the farm-gate price. That is quite a lot below the supermarket price because there are quite a few steps between the farm and the supermarket. It really depends on what is happening to the margins in between and, at the supermarket level, how much of those overhead costs are being attributed to milk versus other product that they sell, because of the large range of products that they sell.

**Senator HEFFERNAN—**You say that there are international market influences on the northern Victorian and southern New South Wales market, but that is not reflected in the returns. Three years ago we had a Senate inquiry when Tasmanian blokes were being paid 16c a litre and the international market was heavily subsidised. Through the subsidised times you say that being captive of the global market is a good thing. Obviously if you are supplying milk to the Sydney market and the international market says your milk is worth 16c a litre because Europe has put on a subsidy and America has matched the subsidy—this is what happened three or four years ago—that is not solution. Besides the fact is that in some areas there has been a reduction in the returns to farmers in the last 15 months, despite the fact that the international market is rising. So they—the consolidated processing industries—are reluctant to pass on the reflection of the change in the international market. Reluctantly they will put it up. They do not automatically reflect it as we see, overnight, with oil. Do you accept that?

**Mr Morris**—I was not commenting on whether it was a good or a bad thing that we were dependent on the international market. I was commenting that it was a fact that we are dependent on the international market. We supply a lot into it and we are a highly competitive supplier. In terms of whether our prices reflect international price trends or not—

**Senator HEFFERNAN—**I mean at the farm gate; I am not talking about the market.

**Mr Morris—**there is evidence to suggest that there is a strong correlation between what happens internationally and what happens in Australia, after you adjust for exchange rate movements. A good example of that is in the graph in our March edition of *Australian*

*Commodities*, which shows the movement of farm-gate prices over time. This is on page 90. For example, in 2007-08, when international prices of dairy products were very high, that was clearly reflected in a peak in prices at the farm-gate in Australia, on average. I do note that there is some variation in what happens in certain markets in Australia. Clearly, on average in Australia there is a close correlation between international price movements and what happens at the farm gate.

**Senator HEFFERNAN—**But three years ago the market price here, in Wagga for instance, was 32c to 38c depending on when your contract was written. There has been a hell of a change in the international market. The price for the average for the year now, despite the huge rise in the international market is 40c.

**Mr Morris—**Remember, of course, that the Australian dollar has changed a lot since then, as well. The Australian dollar at the moment is at parity with the US dollar and—

**Senator HEFFERNAN—**I understand that.

**Mr Morris—**back in 2007-08 I suspect it was probably more in the 70c to 80c range.

**Senator HEFFERNAN—**But that is of no benefit to the guy that has to milk the cow and feed the cow based on a market milk price that gives the margin to the consolidated processing industry.

**Mr Morris—**Yes.

**Senator XENOPHON—**Has the department been monitoring the potential effects of the recent milk price war—the discounting that has triggered this inquiry—on primary production? What analysis have you undertaken? Have you been requested by your minister to look at these issues?

**Mr Morris—**I will answer the first part of the question and then ask my colleague to answer the second part. ABARES has done some analysis of the situation. That was published in the *Australian Commodities* publication which we put out on 1 March. In that there was a box which talked about supermarket price discounting for home brand milk and—

**Senator XENOPHON—**So that document incorporates the price discounting that has taken place recently or is it broader?

**Mr Morris—**This talks about the specific situation of the reduction in prices for milk down to a dollar a litre.

**Senator XENOPHON—**Okay.

**Mr Morris—**This was published on 1 March. We repeated exactly what was in this box in the submission. So it is the same as the information now provided to the committee but it was made public at that time. Essentially that box talks about the three areas which I summarised in the opening statement—the drivers of what might happen at the farm level over time. Just to repeat, those three factors were, firstly, how long the price reduction is sustained; secondly, how processors respond in terms of the price of branded milk; and, thirdly, regional variations. In markets like Victoria, where there is more of an international factor involved, you get the floor on prices but in states like Queensland and Western Australia you get more dominance of the market milk sector, and that can influence the market power of different players and the degree to which prices can, perhaps, be pushed down if those market forces lead to that.

**Senator XENOPHON—**There has been some discussion about the Horticulture Code of Conduct—whether it has been meeting its aims and whether there is scope to adapt this in the current context for the dairy industry. Some have said that it is not appropriate. I think Woolworths may have said that. What role could you see a strengthened Horticulture Code of Conduct playing in dealing with issues in terms of the bargaining power of dairy farmers and others further up the supply chain? Also, Senator O'Brien has raised a question in relation to collective bargaining. Are these matters that you have considered?

**Mr Murnane—**My understanding of the Horticulture Code of Conduct is that it deals with the direct relationships between the producer and the person who buys the produce.

**Senator XENOPHON—**That is right.

**Mr Murnane—**There are a number of intermediaries in that chain, particularly at the wholesale point, whether the relationship is between the producer and the wholesaler or between the producer and the person who sells to the wholesaler.

**Senator XENOPHON—**It does not apply between the retailer and the producer, does it?

**Mr Murnane—**That is my point. In this situation with the price of milk we are talking about what effect a decision by a retailer has on a dairy farmer. That is precisely the point: the horticulture code talks about the direct contractual relationships, whereas in this situation it is at least one step removed.

**Senator XENOPHON—**Has the department considered the potential impacts on the producer of extending the code to apply further upstream in terms of the retailer?

**Mr Murnane—**Not to my knowledge, no.

**Senator XENOPHON—**Do you think that that might be a useful thing to at least get advice on in the context of what has occurred recently? One of the criticisms is that it is too disconnected from what is happening. It applies to the wholesaler but it does not apply to the retailer.

**Mr Murnane—**Yes. But my understanding is that the Horticulture Code of Conduct was introduced to meet a specific need about those contractual relationships. It has been said in front of the committee in the last couple of days that there are also provisions for collective bargaining for dairy farmers that some dairy farmers take advantage of and others do not. Those provisions could be used more.

**Senator HEFFERNAN—**Does the department see the broader context? I bring to the committee's notice an ad in today's *Australian* that I will table. It reads, 'Ensuring environmentally sustainable ethical food production for the world's growing population.' It mentions another ploy by Coles, which is this so-called HGP-free beef thing, which privately Coles will admit and have admitted to me is a con-job on consumers.

**Senator O'BRIEN**—You are not verballing Coles, are you?

**Senator HEFFERNAN**—I certainly am. As you know, it is just a tick in the box at the saleyards. They say that it is a marketing ploy that they hope will work well. How in the long term will the department give consideration to the global food task? This ad is incorrect—it says we have to produce more food from the same land source. In fact, 30 per cent of the productive land of Asia—where two-thirds of the world's population by 2050—will have gone out of production by 2050. So there will be less water, with 50 per cent of the world going short. We will need to double food production. And 1.6 billion people will be displaced—all that sort of stuff. Against that background, does the department have a strategic sense of how the hell we will produce food in the future? Picking up on the theme of this ad, which is signed off by a group of scientists—

**CHAIR**—Bill, it must relate to this inquiry in some way. We cannot broaden it.

**Senator HEFFERNAN**—Milk certainly fits into this, among a variety of other things.

**CHAIR**—I know. Bring it back to the inquiry.

**Senator HEFFERNAN**—How will we produce food that is affordable by the consumer in a way in which that sustains the environment and is viable for the farmer? Do you blokes have a sit down and have a think about that? Obviously, it is a serious problem.

**Mr Morris**—Yes, we do in a number of ways. Probably of most importance is the work that has been done in recent times on productivity in the agricultural sector, both in Australia and internationally. What we have found is that historically the Australian agricultural sector has been one of the most productive sectors in Australia in terms of growth in productivity. We have found, though, that that productivity growth has not been as strong in the last 10 years. That might be because of the drought and dry weather conditions, but we are also conscious that there seems to have been some impact of reduced expenditure by the public sector on R&D over that time.

**Senator HEFFERNAN**—Research.

**Mr Morris**—That is why ABARE have been quite supportive and encouraging of public expenditure on R&D to ensure that we have continued growth in productivity in the future to meet some of the concerns that you have raised and to ensure that the sector remains competitive. The trends that you are talking about in terms of reduced land area are also true for Australia. We mentioned recently that there has been a 14 per cent reduction in land available for agriculture in Australia in the last 20 years. So even in Australia there is a task in terms of producing more food from less land. But Australian farmers have shown themselves to be able to do that very effectively in the past and have remained competitive internationally in doing that.

**Mr Murnane—**The government is in the process of developing a national food plan, which is going to look at issues of food security, sustainability and productivity. That is a process that has just started in the last couple of months.

**Senator HEFFERNAN—**Thank you very much for that. Will that include the sustainability of the farmer as well as the food supply? We want to get paid to get out of bed.

**Mr Murnane—**It is looking at the sustainability of the food industry and those who produce and supply into that industry are obviously key components of it.

**Senator HEFFERNAN—**Would the department have a view on some of the glamorising for market share purposes of such a sensational thing as HGP free? Do you have a view on that or are you not allowed to have a view on that?

**Mr Murnane—**I am not sure that I would necessarily have a view on the effectiveness of the marketing of it and that sort of stuff. My understanding is that Coles has secured a supply chain for HGP-free beef.

**Senator HEFFERNAN—**Allegedly because it is safer to eat.

**CHAIR—**Bill, we are drifting off the terms of reference here.

**Senator HEFFERNAN—**Thank you very much for your indulgence, Chair.

**CHAIR—**This is not a briefing from ABARE; it is about this particular issue.

**Senator HEFFERNAN—**I seek to table that ad.

**CHAIR—**Yes. It is an advertisement from today's *Sydney Morning Herald* that Senator Heffernan seeks to table. It is from a group of scientists about ensuring environmentally sustainable ethical food production for the world's growing population. As the committee is agreed, we will table the document.

**Senator HEFFERNAN—**Senator O'Brien has something very important to say to go with that ad.

**Senator O'BRIEN—**It is related to the ad. I just wanted to say that, when the Tasmanian beef industry sought to promote its product as free of growth promoters, neither Coles nor Woolworths would allow the product in their supermarkets to carry the label indicating that. When the product could be differentiated on that basis, neither was prepared to do it. Now Coles want to say that all of their beef is. Perhaps they at some stage will explain to the public why they now do that.

**Senator HEFFERNAN—**That is a very good question.

**Senator MILNE—**I obviously have not seen the statement that is tabled, so excuse me if it is in the information. You said that, in the work that you are doing on this issue, you are looking at the various factors, including farm gate prices. Have you done an analysis from the farm gate to the retail sector of the different margins? Is there a graph or an analysis of exactly what those margins in various states, for example?

**Mr Morris**—We at this stage only have the information up to the farm gate. In the submission that we provided to the committee, we provided some information on the costs of production for farmers, which is derived from our farm surveys and the price that is received at the farm gate. Unfortunately, there is not a lot of information that we can access at this stage, anyway, on the costs through the rest of the chain through to the retail sector. We would love to have that information, but unfortunately we do not.

**Senator MILNE**—That is an area in which an analysis is absolutely critical to the primary industry sector and not just the dairy sector—vegetable growers and everyone else would like to have that. What we are seeing here is a bias—that is my interpretation. The bias is towards food security or sovereignty being about providing cheap food to consumers. There is no analysis of who is getting what between the farm gate and the retailer. That is a critical issue on which to base government policy decisions. You cannot make judgments about how to interfere when markets fail—and I regard it as a market failure if farmers have to sell at or below the cost of production and there is no margin for them. So what are you going to do to address that? It is not good enough to say, 'We don't know.'

**Mr Morris**—It is fair to say that the market is a pretty complex one. Even if we had that information, disentangling what the market would look like would be difficult. Milk at the farm gate is a reasonably uniform product, although obviously there are differences in milk fats and solids and things like that. But it is a reasonably uniform product at the farm gate. But by the time that you get to the end of the chain you are talking about products that are differentiated between cheese types, butter, skim milk powder, whole milk powder and various types of drinking milks. You have quite a complex food chain by the time that you get to the end point that the consumer sees—and that is not taking into account the influences of the international market. At this stage, we do not have the powers of compulsion to get those players in the market to provide us information on their cost structures and things like that. As I mentioned, it would be interesting to have more information on that, but we do not have the powers to collect that.

**Senator MILNE**—This is absolutely critical for us to determine in the future a food sovereignty strategy for Australia, because, as has been said, it is not only about sustaining the land for food production. We need a framework of policies that enable farmers to stay on the land to farm. In the absence of that information, you are always going to get people saying that this is about providing food at an accessible price. The next set of questions would include: who produces it, where does it come from and does that matter? That is a conversation that Australians want to have. So what powers would you need? Who would need those powers? Have you asked for those powers or suggested to government that those powers be put in the legislation so that you can go and get that information?

**Mr Murnane**—In essence, with the dairy industry no longer being regulated by government, the government is not involved in or aware of the contract negotiations and contract prices up and down the supply chain. Over the last couple of days, this committee has heard and experienced how closely the players guard that information. We are in no better position than anyone else to try to disentangle those pricing relationships.

**Senator MILNE**—I understand that that is what you are saying. The question that I am asking you is: is there any suggestion in this analysis that you are doing on food security in Australia—this plan—for ABARES or whoever to be given the power by government to go and have a look at this? It is a critical component. We need to know what the transport costs are and what the distribution complexities are and so on. This does not just apply to dairy. It applies right across the whole rural community. The key question is: how are we going to keep people on the land? As you rightly said, the dairy industry is extremely efficient. But there is a level beyond which you cannot become more efficient. If that level gets reached, then ultimately farmers will go out of business.

**Mr Murnane**—The answer to your question about whether we have asked government for powers to compel that information from people in the supply chain is no, we have not.

**Senator MILNE**—Is there a reason why you have not?

**Mr Murnane**—Principally because with a deregulated industry we have not considered it to be an area that the government should get involved in.

**Senator MILNE**—You just a minute ago that it would be useful to have that information. Would it be useful to have that information?

**Mr Morris**—That was a comment from me. I know that you cannot see who is talking. I was talking from an ABARES perspective. Certainly in a research sense it would be useful to have that information. That is different than the question Mr Murnane was answering, which was whether that information should be collected or not as a government policy.

**Senator MILNE**—Thank you for that. Chair, I would just like that noted as something that we might consider putting in the final report.

**CHAIR**—Thank you, Senator Milne. We will take notice of the point that you have made. We have probably come to the end of this section now. I thank the witnesses for appearing.

**Proceedings suspended from 10.14 am to 10.30 am**

**ANNISON, Dr Geoffrey, Deputy Chief Executive, Australian Food and Grocery Council**

**CARNELL, Mrs Kate, Chief Executive, Australian Food and Grocery Council**

**CHAIR**—I welcome Mrs Kate Carnell and Dr Geoffrey Annison from the Australian Food and Grocery Council to this inquiry. Would you like to make an opening statement?

**Mrs Carnell**—Thank you. I will make a brief statement to outline some of the issues that we raised in our submission, which I am sure you have all seen. The Australian Food and Grocery Council has absolutely no problems with price promotion or discounting. It is a normal part of retailing. Retailers use it to encourage consumers to frequent their establishments and to promote particular products. It is our view, though, that the current situation that has occurred, particularly with milk but with a range of other products as well, is significantly different to normal price discounting.

To start with, retailers are advertising what we believe to be, and what I think can be shown to be, unsustainably low prices for private label staples such as milk. Coles has advertised that these are prices that are, to use their words, 'here to stay'. What we are seeing is a situation where, when one particular retailer in a market in which we have two major players—and they are very major players, Coles and Woolworths—reduces price on a staple, milk, significantly and announces that that price is here to stay, there is absolutely no choice, in the sort of market that we have, but for the other major player to reduce their price as well.

We always have to remember that in Australia the level of concentration in the supermarket space between Coles and Woolworths is significantly higher than anywhere else in the world—certainly than in comparable countries. Depending on the sorts of products we are talking about, it is something like 75 per cent of the market. The world's largest supermarket owner, Walmart, has somewhere between 13 and 18 per cent of market share in the United States and in the world.

**Senator XENOPHON**—They have antitrust laws, though.

**Mrs Carnell**—They do have antitrust laws, Senator. You are absolutely right. And that is of course the reason that that is the case. This shows, really, the difference we have in the Australian market. Coles announcing the price changes to milk and other products makes it extraordinary difficult for Woolworths not to match those prices, which of course they have done in the milk space. That has produced a scenario where consumers are being encouraged to buy the one dollar a litre milk product. It has produced quite a significant gap between the private label product and the branded product and we are already seeing, at least anecdotally, a shift to the private label product.

It is our view, and this is probably just a statement of fact, that over time the dilemma for the branded product manufacturers is that if they do not look at moving their price down so that it is closer to the private label product they will lose market share significantly. I think we need only to have a look at the UK situation, where similar approaches were taken by some of the supermarket chains. The market share of private label is in the 90 per cent range; it is up there. So branded product really does not exist in the UK, even though the fresh milk market still does.

As we said in our submission, I do not think that anybody in Australia could say that the sorts of margins achievable on milk production in Australia of between 1 per cent and 3 per cent are extraordinarily high. When you consider that in the fresh drinking milk the infrastructure requirements—the refrigeration, the trucks, the picking up milk from a range of farmers, the processing requirements—require quite significant amounts of investment, so to maintain that level of investment requires companies to produce a reasonable return on investment. At the lower end of the 1 to 3 per cent margin, and that is where the private label product fits in, that return on investment simply is not possible, so there will be no choice for processors to pass on those price reductions to farmers over time. We all know that processors are certainly not making a huge amount of money here nor farmers, so the long-term outcome of this has got to be negative for the processing industry and also for the farm industry in this country.

In a nutshell that is the basis of our submission. We have gone into a range of the questions you have asked as well. I am happy to answer any questions, as is Dr Annison.

**CHAIR—**Thank you. Yesterday we heard from National, and certainly what you have said about the profit margins of processors seems to be very true. They are being squeezed very tightly. But at the beginning of your statements you referred to the UK situation. Do you see any analogies between what has happened in the UK and what appears to be developing in Australia?

**Mrs Carnell—**We see it as being exactly the same approach, really. As we know, we have a global market, and Coles has, I think, looked to the UK situation and used a similar approach. So we would have to assume we would get a similar outcome, which is that brands either cease to exist or become very small gourmet players, I suppose, in the space, and that means that we are setting a new base price in the milk arena. There will not be multiple different levels. The new base price is a dollar a litre, and that will mean the whole supply chain that we are talking about will reflect that new base price.

**Senator HEFFERNAN—**Can I just point something out. I was talking to a Scottish farm the other day. He gets a subsidy of £100,000 to stay on his farm—before he starts farming. We are not allowing for that here in Australia.

**CHAIR—**There are a lot of farm subsidies in the EU, so that is not surprising, in a way. I have another question I want to ask you. We are told that a lot of Australia’s milk is exported. Where does that fit into the broader picture? Certainly it seems that as far as the domestic market is concerned the Australian dairy farmers are being squeezed, but I would not have thought that that flows on to the export market so much and so there are still export options and other product options.

**Dr Annison—**What you say is true. You have probably noticed in the submissions that have been already made to the committee, particularly in the national foods submission, for example, the structure of the Australian dairy industry is such that there are two major milk producing systems. One is for the domestic milk production and the other, which is broadly termed marketed milk, and the other is the manufactured milk sector.

Most of the manufactured milk and milk products that go for export come from milk that is from the southern states and predominantly Victoria. Some of that production in Victoria also goes to drinking milk in Victoria. In New South Wales and Queensland most of the production goes directly to the domestic sector and the drinking milk sector is in that area. So whilst it is true that the base milk price goes to producers in the southern states is driven primarily by the export market, through organisations such as Murray Goulburn, the drinking milk market in New South Wales and Queensland is determined primarily by the domestic market. So there is a balance, and in some cases companies and farmers have the choice of directing milk either to the drinking milk market or into the manufactured milk market. That is an option that is predominantly provided for in the southern states of Australia rather than New South Wales and Queensland.

**CHAIR**—Are you saying that, in effect, this is not such a big issue for the Victorian dairy farmers?

**Dr Annison**—I think it is still a substantial issue for Victorian dairy farmers, particularly when, as you would be aware, the international prices for commodities such as skim milk powder tend to go up and down, so they are exposed to international prices. They then have the opportunity of buffering that against the domestic price. The same is also true if domestic prices go up and down. They have an opportunity to buffer against the international prices. It is when they both go down together, particularly when they are set at very low levels anyway on the domestic market, that pressure can be put onto producers and also the processes who are manufacturing the milk products that go offshore.

**CHAIR**—Is there any reason why the Western Australian, Queensland and northern New South Wales producers could not get into the export market? I just want it on the record.

**Dr Annison**—The main barriers are the size and investment required and the ultimate return that they would get. These are classic economic barriers to entry to market.

**CHAIR**—It is important to establish that there are issues about them getting into that market.

**Mrs Carnell**—It is also true that farmers do not wake up every morning and say, ‘Am I going to send my milk to the drinking market or to the export market?’ These decisions are made well in advance and based upon infrastructure and capacity and all sorts of other things.

**Dr Annison**—That is absolutely right. One more factor that has pointed out in the submissions is that the supply of drinking milk and is different from the supply of manufactured milk. Manufactured milk can be seasonally produced. The production of milk in any individual cow or herd is essentially seasonal, whereas in order to provide for the drinking milk market it has to be averaged over the course of a year and so the production systems used by the farmers are different. So there is also that barrier of quickly swapping from one market to another. That option is not really available for individual farmers.

**CHAIR**—Thank you very much.

**Senator O'BRIEN**—I just have comment that the reason that northern New South Wales and Queensland do not make much in the manufacturing milk sector is that their cost of production is far higher than that of southern Australia.

**Mrs Carnell**—It is.

**Senator O'BRIEN**—The prices now show that milk producers in those parts of the country are paid significantly more per litre because the fresh milk or market milk sector wants to process milk that they do not have to transport from Victoria.

**Dr Annison**—Indeed.

**Senator O'BRIEN**—Therefore, the marginal cost of paying more in Victoria is less than the cost of transport. I think, historically, if you go back to pre-deregulation, with regulated prices, it was the same margin and anything that went into manufacturing milk was effectively subsidised by the higher priced paid for drinking milk to those dairy producers.

**Dr Annison**—Yes. I think there are also technical problems with transporting the milk up from the south.

**Senator O'BRIEN**—The technical problem was to do with refrigeration in bulk. Ultimately, one would think that if you wanted to and were prepared to pay the price you could ship packaged milk in refrigerated transportation. It would cost more, but if it was not produced in the north that would be a way of having fresh milk if that is the way the industry went—not that I am saying that that is how it should go.

**Mrs Carnell**—It certainly is, but at a dollar a litre—

**Senator O'BRIEN**—It is not going to happen.

**Mrs Carnell**—It is absolutely not going to happen. You have to remember that $1 a litre are the sort of consumer prices that would have been expected back in the 1990s. I do not think any of us contemplate for a moment that the price of production or processing is the same as it was back in the 1990s. It makes it pretty clear that the margins here are incredibly tight.

**Senator O'BRIEN**—It is fair to say, isn't it, that the arrangements since deregulation have seen a great compression in the margin of processes in the dairy sector and not necessarily compression in the profitability in the supermarket sector?

**Mrs Carnell**—If you have a look at margins of one to three per cent, when you consider the complexity of the industry—picking up from 1,000 farms, the refrigeration issue, the processing issue, the health and safety issues—this is actually quite a complex business and therefore quite a costly business. Those sorts of returns are pretty low. Again, I stress that the only thing that sort of keeps it afloat at the moment is the fact that the margins on branded product are somewhat higher than on private label. If all we are selling in the majority of Australian supermarkets is the private label product of the one per cent area it does, fundamentally, destroy the whole supply chain.

**Senator O'BRIEN—**That is the competing argument that everyone has to deal with in the consumers' demand for a lower price. I wonder if you can help the committee in this regard. Which is the greater pressure on the Australian food manufacturing sector in this country, pressure from the supermarket chain and private branded products or imported product and the competition of imported product and the pricing thereof?

**Mrs Carnell—**Both. It is called the 'pincer effect'. The dilemma for manufacturers in Australia right now is—as we all know right across the board—the cost of wages, increasingly the cost of power, transport and infrastructure generally. Australia is not a cheap manufacturing destination. We know that. It is a challenging space. The cost of imports has gone up. The cost, of course, of the world commodities in the food space are at, in many cases, record levels. Sugar is higher than it has ever been. Wheat is back to record 2008 levels. In fact overall the food world commodity index is at an all-time record level. Commodity prices in the global space have gone up and at the same time the price war between our two major supermarkets has been alive and well, so margins are being squeezed. As we have heard from the supermarkets 5,000 products are being reduced and those sorts of things, and costs have not gone down. At the same time the Australian dollar is at a parity or a bit better at the moment meaning that imports are cheaper. If you think about maybe the 'perfect storm' for Australian food and grocery manufacturers, we have it. The issue is margin. Their capacity to flow through the increases in margins, both because supermarkets are having a price war and because they are competing on Australian supermarket shelves against imported product that is proportionately cheaper at the moment, is a real issue.

**Senator O'BRIEN—**It has been suggested to this committee that what happens in the milk sector is that the processors increase the price of their own brand to try and compensate for the fact that the margin on the supermarket brand milk is so low. Firstly, do you have a comment on that suggestion and, secondly, if that is the case in milk, is it also the case in other manufactured food products in the Australian market?

**Mrs Carnell—**There is not a capacity for processors to put up prices on their branded product exponentially. We know that many consumers will pay a little bit more for a branded product, one that they know and they feel safe and comfortable with. The level of the gap is very much market driven. You cannot just charge anything and expect people to keep buying it. I think the UK situation with milk where branded product virtually ceased to exist is a good example of what happens. The gap is finite and it is not actually that big, I would have to say.

**Senator HEFFERNAN—**Milk ain't milk like oils ain't oils. People get used to the taste of the milk that is reduced to the minimum protein and fat and they do not give a rats about it.

**Mrs Carnell—**They will pay a little bit more for a brand that they trust and that they feel comfortable with.

**Senator HEFFERNAN—**I am sure you are right.

**Dr Annison—**I think with a product like milk it is certainly true that the manufacturers use their branded milk product to essentially subsidise the supply of generic milks and private label milks to the supermarkets. I think that has been stated by most of them. Obviously with something like drinking milk it is a fairly standardised product and there is not a lot of variation from one product to another, particularly with the demands of the foods standards code and what the requirements are in things like protein and milk solids and so on. In other products historically where the processors have had a greater opportunity to vary the product, in other words the quality of the product, they have tended in the past to keep the quality of the products they make for the supermarkets at a lower quality level than their own brand of products. This is going back 10 or 15 years. In recent times, however, the pressure from the supermarkets has been such, particularly for their premium supermarket brands such as the signature brand in Woolworths, to demand from the manufacturers that the home brand products that they make for the supermarkets are the same as their own branded products. This has meant that the differential between the branded products and the generic products has decreased in quality and also, consequently, it has decreased in the ability of the manufacturers to differentiate and gain a premium on price. This means that the margins of the manufacturers has been squeezed to the extent that they are reconsidering manufacturing in Australia.

I think in our submission we make direct reference to tinned fish. Fifteen years ago a lot of the tinned fish that was on the supermarket shelves was supplied out of tins manufactured in Australia, either at Bega in southern New South Wales or Port Lincoln in South Australia. Now those small cans of tuna and salmon you find in the supermarkets are all manufactured offshore. There is no manufacturer in Australia. One of the reasons has been consistent and aggressive discounting that has occurred over that category. We are concerned that in other categories that will follow on and, of course, potentially the same in some dairy products.

**Mrs Carnell—**It is important to make the point that the difference here is that, if we did not have quite the level of concentration in the supermarket space, if, say Coles had 10 per cent of the market, it would not have caused everyone else to match. But because of the nature of the market we have it does produce this matching scenario or the race to the bottom.

**Senator HEFFERNAN—**They are not listening though. We have been talking about that for ages but no-one listens.

**Senator O'BRIEN—**The question then is: does your organisation support the pursuit of divesture laws and needy trust type laws in Australia, and are greater controls needed on mergers and acquisitions than currently exist or does there need to be a stronger policing of existing laws?

**Mrs Carnell—**What we have suggested in our submission is that we would like parliament to have a look at a supermarket ombudsman to actually look at some of these issues or have the power to have a look at a number of the competition issues involved. We would like the Trade Practices Act to be looked at again particularly in the competition space, the predatory pricing space and to get a few more teeth in that arena. We have suggested that it might be a good idea maybe prior to any decisions at the sort of level you are talking about now to get the Productivity Commission to really have a look at what the flow-on of the current concentration in the supermarket space is really causing in terms of productivity and for that matter the long-term viability, not just of farmers but of processors and that means food security. We are not saying that that is the answer because that is a pretty dramatic approach. I think all Australians care about long-term food security in this country and we really do need to have a look at the whole supply chain effect of what we are seeing at the moment in the medium to long term. I do not think we know that just yet.

**Senator O'BRIEN**—Thanks for that. Some might argue that that is putting the problem off until later.

**Mrs Carnell**—I do not think it is. I do not think you would jump into something like anti-trust laws or divestiture or whatever until you had really determined what the cost benefit of that was.

**Senator O'BRIEN**—I am sorry, maybe you misunderstood my question, but in creating divestiture powers were it was determined that the ownership and competition arrangements were deleterious to full competition, for example—

**Mrs Carnell**—Maybe what I am saying is that we would be fully supportive of, say, a Productivity Commission look to determine just what the impact of those sorts of approaches and the current situation is going to be on Australia in the longer term in an era when we have to look at parity dollar and a range of things we have not dealt with in the past, including commodity prices continuing to be fairly high or very high in the world market. It is a different world that we are likely to face in the next 10, 20 or 30 years and I think we have to look at that really seriously from a food security perspective.

**Senator HEFFERNAN**—From the evidence that we have received—other than Coles who have not appeared—no-one thinks that what we are doing now is sustainable and the tinned fish thing is where we are headed. It is really a question of whether consumers can afford fresh milk.

**Dr Annison**—Consumers obviously want fresh milk and fresh milk is one of those products where sales are relatively inelastic against price because it is used so ubiquitously—

**Senator HEFFERNAN**—So can they afford fresh milk at a sustainable price?

**Dr Annison**—Obviously, they can afford more fresh milk when it is cheaper than when it is expensive. The question is whether in the longer term they are going to be able to afford—

**Senator HEFFERNAN**—But if they are prepared to buy a bottle of water, depending on the price of the 650 ml, one litre or two litres bottles it varies somewhere between 1,200 times and 3,400 times the value of the water if you put the bottle under the tap. Maybe the supermarkets with 82 per cent of the packaged market can have a war over water and not milk.

**Mrs Carnell**—People can afford fresh milk. They have for a long time.

**Senator HEFFERNAN**—If they can drink bottled water, they can afford anything.

**Mrs Carnell**—We have a great product. What we are seeing is a price war on a product that people are willing to pay a reasonable amount for, in our view. We have proven that. People are willing to pay a reasonable amount to give a reasonable return to supermarkets, processors and farmers. We are lucky with our milk supply. The price war at the moment has nothing to do with milk. It has a lot to do with market share—

**Senator HEFFERNAN**—And the $38 million bonuses to take back to Scotland. There is 3.3c worth of water in a bottle of water that has cost $2.50—we were importing it from China at one stage, landing it here at 28c and retailing it at $2.50, the rocket red bottle of water fully imported from China. God help us.

**CHAIR—**Things are not what they used to be, Bill!

**Senator HEFFERNAN—**This is all about sovereignty though. This is the bigger question of the changing model of living together in the world. We are losing our sovereignty.

**Senator XENOPHON—**So you are effectively saying that what we are seeing now is a manifestation of the market power of Coles and Woolies controlling 75 or 80 per cent of the market?

**Mrs Carnell—**The current situation would not have occurred if the market did not look like it does.

**Senator XENOPHON—**You could say it is a manifestation of that.

**Mrs Carnell—**You could.

**Senator XENOPHON—**In your submission you talked about the need for a food and grocery ombudsman. How would you see that working? I know Choice has been calling for that for a number of years. Are you broadly in step with what Choice has suggested? How would you see it working in the context of having a useful role to play for these sorts of issues?

**Mrs Carnell—**We have been talking to Choice about it, and we are broadly in line with the view that Choice have. We also think it would be a good idea to have a look at the UK supermarket ombudsman that was set up 18 months or so ago to have a look at how that has worked, things that could be improved and so on. I think the important bit about a supermarket ombudsman is to give Australian manufacturers, particularly in the small to medium space—the people who are not the brand leaders but the next rung down, the innovative Australian guys. The power imbalance is quite significance. Where ombudsmen work is where you have got a power imbalance you want to make that a little bit more even. I think that is what we might be able to do if we get this right.

**Senator XENOPHON—**Would you see the ombudsman having a useful role in the sense of highlighting or blowing the whistle on unfair practices?

**Mrs Carnell—**That is what ombudsmen do.

**Senator XENOPHON—**And making recommendations for legislative change.

**Mrs Carnell—**Yes.

**Senator XENOPHON—**In terms of the feedback you are getting from your members, you agree that this milk price war is unsustainable?

**Mrs Carnell—**Yes.

**Senator XENOPHON—**What impact do you think that will have on some of your members, particularly the small to medium-size processors?

**Mrs Carnell—**If processors cannot make a reasonable return on investment, then there are two things you can do: you close down or you move offshore. There is not another option. We talked about tuna a minute ago. You move offshore. In situations where you cannot do that, you close down. I think sometimes it is not recognised that food and groceries manufacturing is Australia's biggest manufacturing industry. Of there 288,000 people we employ, half of them are in rural and regional areas. When you talk about some of these places moving offshore or closing down, it is regularly the major employer in that regional area or country town. It has a broader impact than just saying, 'Oh, well, we'll be able to buy an imported product. It will be the same in the end.

**Senator XENOPHON—**While some economists talk about an overall benefit, it does not take into account the very specific regional impacts that can be quite profound.

**Mrs Carnell—**Our view is that if the companies that we are talking about cease to manufacture in Australia or cease to exist, then the infrastructure, the fabric possibly, of a lot of rural towns in Australia is significantly undermined. The major employer in town is no longer there; it is pretty clear what happens to the town.

**Senator XENOPHON—**Finally, you refer to having a comprehensive review of measures within the—I keep saying TPH—the competition and consumer—

**Mrs Carnell—**The competition and consumer thing, yes.

**Senator XENOPHON—**You might want to take on notice as to what specific changes you think might be useful in the context of your submission.

**Mrs Carnell—**We are happy to do that. We have got some views on section 46, section 49 and looking at whether bringing back section 49, I think it is, is something that should be looked at seriously.

**Senator XENOPHON—**Thank you.

**Senator COLBECK—**I want to go back to Senator O'Brien's questions in relation to the relationship between supermarkets and imports on the effect of manufacturing in Australia. Have you got any figures on that? My view is that supermarkets are partly driving this by being active importers in some food lines. They tell us fervently that 95 per cent of their fresh product is Australian sourced, and that is probably right, but supply of the food task is not all about the stuff in the fresh section of the supermarket. There is fair chunk that is in other elements as well. Do you have any figures on those particular areas? You talked about the gap between generic milk and branded milk and there being a defined gap. I was wondering whether you thought that this current campaign has broken that gap beyond the market tolerance?

**Mrs Carnell—**In answer to the last question: absolutely. People will not pay $2 more. I think it is also important to remember that by breaking that, by having a scenario where people will not pay the difference, it is not just processors and farmers that suffer. It is all of those milk vendors, corner stores, convenience stores that rely on people saying, 'I'll just pop in and buy the milk,' or 'I'll get my petrol and get some milk.' That is a huge part of their business. When there is a big gap, when people say, 'Yes, but it is so much cheaper if I go to the supermarket. I won't buy it anymore,' it has a huge potential to flow on through that small business convenience store market.

**Dr Annison**—We do not have direct figures on the generic branded products and what proportion are imported. Imported foods I think have gone up to about $8 billion a year now—those are our last figures—compared to about $2 billion a year 10 years ago. The trade difference between exported food and imported food in the processed food sector has halved in the last five years, so the gap between imports and exports is closing and we are losing the trade advantage that we did have.

Our concern with the generic brands and importation is that the generic brands can select a manufacturer essentially anywhere in the world to provide them with packaged shelf-stable goods. So they could go to an Australian manufacturer and say they would like canned tomatoes or a breakfast cereal and, if the Australian manufacturer can provide it to them at a certain price, then they would do so but, if not, the supermarket can go anywhere in the world for an alternative. That is fine but they do not have the same constraints that the Australian manufacturer has. The Australian manufacturer has a manufacturing plant here in Australia—they have the capital invested in Australia—and cannot as easily move the sources of their branded products as much as the supermarkets can.

So we are concerned that over time if there is a great deal of pressure on the margins of manufactures, either through direct manufacturing of generic products or through the flow-on to the branded products, that the business case for maintaining manufacture in Australia will be eroded. The long-term consequences of that are of concern to us.

**Mrs Carnell**—The reason we have asked for the Productivity Commission or someone like that to have a look at this is now the production and manufacturing prices of a whole lot of products, even out of New Zealand, are significantly lower than the similar products out of Australia. We can look at vegetables and so on. That is a real issue for this country. It is one thing to say, 'How do we compete with China?' but, if we are having trouble competing with New Zealand, that becomes even more of an issue, doesn't it?

**Senator COLBECK**—I was going to come back to the longevity of interest if there is not enough return for that capital reinvestment. In relation to your discussion about competition with New Zealand, we have just seen McCain, for example, take all of their vegetable processing to New Zealand from Australia. One of the issues there has been investment or reinvestment in their plant. Obviously in a number of other manufacturing sectors the incapacity to get a return for reinvestment or get a reinvestment case up is having an impact on that overall price.

While still providing a competitive product at a reasonable price for consumers, we need to make a value judgment as to the scale, shape and scope of our manufacturing sector for food in Australia, whether we want to concentrate our supply chain with the supermarkets and what the tools are we have to shape that—if that is the track we want to go down. They are some of the questions. How do we achieve those value points once we have decided what they are?

**Mrs Carnell—**That has been the challenge for a long time. I suppose that is the reason in our recommendations we have tried to say that there is probably not a silver bullet here but a mix of looking at the Trade Practices Act, the Productivity Commission and a supermarket ombudsman. There are a range of things that will need to be done, plus really having a look at what our plans are to ensure food security in Australia in the longer term so that we still do have a processing and manufacturing industry in Australia, outside possibly very short-shelf-life stuff.

Remember that we used to have quite a significant grocery manufacturing industry in Australia not that many years ago. I tell you what: there are not many players left manufacturing predominantly in Australia any more. With a longer shelf life they can get product onto the supermarket shelves in Australia with better margins from offshore. We certainly do not want that to be the situation in the food space as well. If we do not look at this really seriously, that is what we will be facing.

**Senator COLBECK—**There are some that would say it does not matter where it comes from as long as it is cheap. Do you think there is genuinely a food security argument underpinning this?

**Mrs Carnell—**I do. We believe that it is important for Australia to value add product in this country. Yes, Australia can continue to produce great wheat, put it in ships and send it overseas and bring back all the products that are made from it. We can send live cattle and sheep and so on overseas and bring back whatever we want, but I think that for long-term food security in this country and for rural and regional jobs, we have to be in a position to actually value add the products here in Australia to ensure that Australia is pulling its weight in global food production, is able to provide a good majority of the products Australia needs every day—not all of them. There is a global market. But if we do not do that, we are fundamentally just shipping commodities offshore and shipping jobs offshore with them.

**CHAIR—**We do that with minerals too.

**Mrs Carnell—**We do.

**Senator HEFFERNAN—**You send over wool and you bring it back at $800 worth of suit length, 1½ yards.

**Mrs Carnell—**That is true. We do not want to do that as well in the food space—send off the bulk wheat and—

**Senator HEFFERNAN—**Australians go to the supermarket and think, ‘It’s down that aisle’ they do not think where it has come from as long as it is cheap, as you say. Does the Food and Grocery Council have a view of the world in 50 years time and in 80 years time at nine billion and then 12 billion people? Does anyone realise that we are getting it cheap from China and that by 2070 China cannot feed half its own population of $1.8 billion people from its own resource? Do you think that through?

**Mrs Carnell—**Absolutely. That is the reason we believe really strongly that Australia has to maintain a strong processing and manufacturing industry. We do not want to be reliant on other parts of the world for the food in those supermarket aisles that we are talking about. Yes, we like imported food and we like the variety we get, but we do not want to be totally reliant on it. We want to ensure that Australia value adds.

**Senator HEFFERNAN—**Do you think the political process and the consumers at large are engaged in this thinking?

**Mrs Carnell—**I think we have to get them engaged.

**Senator HEFFERNAN—**Thirty per cent of the productive land will have gone out of production in Asia by 2050 and there will be double the food task because two-thirds of the world's population is going to live in that area. And we are going to import food from them? Pull the other leg.

**CHAIR—**That is a good point.

**Senator HURLEY—**I want to go back to the matter of the ombudsman. There is Produce and Grocery Industry Ombudsman. What function do they perform?

**Dr Annison—**The ombudsman under that system was originally set up to address potential inequities in the wholesale fruit and vegetable market. As you know, there is an alternative horticultural code that has also been developed and come into play quite recently. The structure of horticultural industry is somewhat different from that in the dairy industry, as you would be well aware. So, whereas the principles that underline that committee and the ombudsman do apply, the practicalities of it might not be directly transferable across to the dairy sector. But the principle of having an independent adjudicator who can look at the trading practices between different parties up and down the supply chain is appropriate.

**Senator HURLEY—**So that ombudsman is not capable of looking at this issue because it deals mostly with another area. Is that what you are saying?

**Dr Annison—**The origin of that particular ombudsman came out of the wholesale fruit and vegetable sector. That was characterised by many very small producers up and down the country sending produce to wholesale fruit and vegetable markets, such as the Flemington market in Sydney, where there are agents that then take over the supply into the retail sector and also the restaurant sector, for example. Because of the complexity of that and the lack of direct systems, particularly 15 to 20 years ago, that particular ombudsman was first mooted and came into action.

As I think we have said in response to your question in the inquiry's terms of reference about the horticultural code of conduct, because the structure of the industry is different, it might not be appropriate to ask those ombudsmen of those systems to look directly at the dairy sector. But we have supported in our submission The principle of having an ombudsman.

**Mrs Carnell—**In terms of the supermarket ombudsman, though, we—

**Senator HURLEY—**Is this another one?

**Mrs Carnell**—No, it is the one we have recommended in our submission. I have to say it is not new for us. We have recommended it before in submissions and other places. It is broadly about looking at the issues that suppliers, manufacturers and others have in that relationship with supermarkets and why you need it. Why do you ever need an ombudsman? They are a power and balance. There are people who—

**Senator HURLEY**—Do you talk to Coles and Woolworths? Has your organisation attempted to do that?

**Mrs Carnell**—We do not represent Coles and Woolworths. We speak to Coles and Woolworths all the time about a whole range of things, so our relationship—

**Senator HURLEY**—But not about this issue in particular.

**Mrs Carnell**—Not about this issue in particular.

**Senator COLBECK**—Have you done any work on supply chain costs for cold chain versus running something through a UHT supply chain and what the difference in those costs might be?

**Mrs Carnell**—No, sorry. We have not.

**CHAIR**—We thank the Australian Food and Grocery Council for appearing.

[11.16 am]

**KING, Professor Stephen, Dean of Faculty of Business and Economics, Monash University**

*Evidence was taken via teleconference—*

**CHAIR—**I welcome Professor Stephen King. Thank you for being patient. Would you like to make an opening statement?

**Prof. King—**Thank you for the opportunity to talk to you today. I would like to outline what I see as being the issues relating to the discounting of fresh milk and home brand fresh milk in particular by Coles supermarket and by obviously Woolworths and the IGA chain and Metcash. If we start off where the focus has been, which is on dairy farmers, I think it is useful to break dairy farmers themselves into two groups, particularly post deregulation. There are really the groups where the farm gate price is pretty much set by the export parity price, and I think that applies mainly to the farmers in southern Australia, particularly in Victoria, then the farmers who are in areas that are not so involved in the export market, so their marginal sales of milk are much more closely aligned with supplying fresh milk to the local markets. Take Queensland as an example of that. They are not as separate as I am stating here, because the export price affects the Queensland farm gate price as well as the Victorian price. But I think it is important to start with that separation and to think about it because those farmers will be potentially differently affected.

For the Victorian dairy farmers where the farm gate price tends to follow the international price, there is likely to be little if any effect of the discounting from Coles. That is not likely to affect the international price in any way, and it is that international price that is driving the farm gate price. That is where the marginal milk goes in Victoria. I have an analogy to make it clear why if you are selling into an international market, you have little to gain or little to fear from discounting in supermarkets. At various stages there have been bread price wars in supermarkets. The one I am most familiar with was in the 1990s in Victoria, where Safeway and a number of other players were discounting bread to below 99c a loaf. I am familiar with it because Safeway in that situation found it was getting a little bit too hot for them, if I can put it that way, and engaged in some anticompetitive conduct. Later, Safeway were found guilty of that anticompetitive conduct, essentially trying to push up the price of bread, by the Federal Court. From memory, that case was brought in the late 1990s or early 2000s.

In that situation why was there not an equivalent response by wheat farmers? The price of bread is going down at the supermarket and that is going to affect wheat farmers. But the bulk of the wheat price that farmers get is set by the export price. What happens on the domestic bread market is trivial from the point of view of wheat farmers, their price, the yield they get on their crop, depends on the international price. Dairy farmers are not nearly as exposed to the international market as wheat farmers, but for those dairy farmers where their farm gate price is set by the export market they have little to gain and little to fear from Coles discounting milk.

When we turn to those farmers who are much more exposed in terms of the domestic fresh milk market there are two obvious possibilities. The first is that Coles’ milk pricing strategy is sustainable and is a long-term strategy, the second is that it is unsustainable, it is a short-term marketing gimmick and will be gone within a year. I have no idea which of those is true, so let me start with one and then I will consider if things change under the alternative.

If this is a sustainable strategy then fresh home brand milk is going to be in the class of products along with things like Coca-Cola, nappies and those products which are regularly used as what I will call 'loss leaders' by the supermarkets. I am using that term loosely, I have no idea whether supermarkets make a loss on Coke, nappies or on selling their home brand milk, I simply do not have the information, but they are products that the supermarkets use. They are priced very cheaply and they use them to entice people into the stores on the basis that, once you are in the supermarket. you will buy a basket of groceries. They may make a loss on the loss leaders but the supermarket makes that up through the profit it makes on the other contents of the basket.

Let us assume that is where Cole's is going in that situation. The one fact that stands out in the Coles' strategy is that Coles is going to need certainly not less fresh milk almost certainly it is going to need more fresh milk. We would expect milk sales from Cole's supermarkets to go up. Unless milk is an extraordinarily unusual product—in other words, it is a product for which demand has not slowed down—milk sales generally will go up as prices go down. As other sellers of milk products are forced to lower their prices to match Coles to keep their customers, you would expect total milk sales to go up. Sales may not go up by very much, demand may be fairly insensitive in the short term, but you would expect over the longer term there to be some, possibly small, increase in milk sales. That means the milk has to come from somewhere. The only place that milk can come from is going to be dairy farmers in Australia.

How are the dairy farmers going to be given the incentive to provide that extra milk? Dairy farming is, as far as I can tell, not an industry where people are making substantial profits. In fact, as far as I can tell, the marginal dairy farmer, quite frankly, is doing it very tough. The marginal dairy farmer is struggling to hold on to their farm to their business and to keep operating. If their farm gate price drops, chances are that maybe not in the next month or in the next three or four months but over a longer period of time, that farmer will go bankrupt and exit the industry.

If Coles wants this as a sustainable strategy, that means there will be more fresh milk sold in Australia. If that then flows through to lower prices at the farm gate, then all that will happen is that there will be less milk sold, because there will be less milk produced. Those two things cannot exist together. The only way that Coles and other sellers of milk are going to be able to sustain the lower prices in the longer term—and remember I am taking the initial assumption that this is sustainable—is if they push up the farm gate price, particularly in areas like Queensland, where they are dependent on those farmers to get their fresh milk supplies. The farm gate price is not going to go down. If it goes down, that will just cause farmers to go bankrupt and will mean that you end up with stock-outs of milk occurring in the supermarket. Stock-outs of milk in supermarkets is not a sustainable marketing strategy. It is the best way to get your customers upset.

If we are talking about sustainable strategy from Coles, simple economics says that the farmers will probably benefit. Some farmers, particularly those exposed to the export markets, will probably notice no difference. Those highly exposed to the fresh milk market in Australia have to be convinced to supply more milk. That will mean that they have to be given a higher farm gate price, certainly not a lower farm gate price, because that would lead to bankruptcy.

**CHAIR—**Professor, the senators would like to ask you some questions about what you have said if that is okay. We only have a limited amount of time.

**Prof. King—**Yes. We can turn to other participants such as the processors and the competitors, where I believe there will be significantly different consequences.

**CHAIR—**I will ask Senator Xenophon to begin.

**Senator XENOPHON—**Professor King, you are making certain assumptions. Isn’t the demand for milk relatively inelastic?

**Prof. King—**My understanding is that the demand for milk in the short run—and I have not gone back to look, but I suspect there are ABS studies on this—is relatively inelastic. But remember that ‘inelastic’ means that, as the price goes down, the quantity sold will still go up. It may not go up by a huge amount, but it still requires there to be more milk sold, not less milk.

**Senator XENOPHON—**What is your definition of ‘short run’? What did Keynes say? ‘In the long run, we’re all dead.’ So what is your definition of ‘short run’?

**Prof. King—**In terms of the standard analysis for industries such as milk, and when you are looking on the demand side, it is to say how quickly would you expect consumer habits to change so that they can adapt from their current activities, the activities they have been doing in terms of their consumption patterns, to adopting new consumption patterns that involve a true reflection of the new prices. For example, if somebody has been using less milk—they may be a soy milk drinker, to give a simple example of a substitute—as the price of milk goes down they may say, ‘I’ll use less soy milk in my cooking; I’ll use real milk in my cooking.’ Or someone may use less powdered milk in their cooking and use more fresh milk in their cooking, as it becomes cheaper.

**Senator XENOPHON—**So what is your definition of ‘short run’, going back to the question? Is it six months, 12 months?

**Prof. King—**For ‘short run’ you would be looking at the next couple of months. Longer term—and again this is something that you need empirical evidence on—I suspect that consumer buying patterns would change probably over a six- to 12-month period.

**Senator XENOPHON—**Woolworths have said in their submission—we do not have a submission as such from Coles yet—and the Australian Food and Grocery Council and Dairy Farmers have also said that this is not sustainable in terms of supply chain, that this will be seen in the price that farmers get. Is that something that should be taken into account—the fact that, if the price is so low it will impact on the supply chain and it will be uneconomic for a number of dairy farmers to continue producing milk?

**Prof. King—**There may be issues for processors, but, if we go back to the dairy farmers, as long as the demand curve for milk does not slope the wrong way—even if it is inelastic—it means there has to be more milk. Sending dairy farmers bankrupt by pushing down the farm gate price—and that is basically what ‘unsustainable’ means; it is going to be a farm gate price that sends dairy farmers bankrupt—will not lead to the extra milk that will be demanded by consumers. That will mean that you will walk into Coles to buy that cheap milk and they will not have any on the shelves. That is a good way to upset your customers. You can ask Coles yourself, obviously, when they appear before this inquiry, but I think that is a situation that Coles will be avoiding at all costs.

**Senator XENOPHON**—I am very interested in what you have to say. It is just that you made an assumption in your opening statement that it is not in the interest of Coles to do this. Let’s say if this is a case where Coles is being driven by the need to increase market share, if for instance some of the Coles senior executives will be getting multi-million-dollar bonuses for increasing market share, they are not considering—

**Senator HEFFERNAN**—You are not on Coles’s payroll are you, Professor?

**Senator XENOPHON**—My question is this: have you not made an assumption that Coles is concerned about what the impact will be on the dairy industry, but if they have been focused on something else—that is, to increase their market share—doesn’t that undermine your assumption with respect to what Coles is thinking of in terms of the potential impact on the dairy industry?

**Prof. King**—No, not at all. I am not making that assumption. My assumption is simply that Coles is running this as a marketing campaign to maximise its own profits. It cannot do that unless it gets hold of the milk to be able to sell.

**Senator HEFFERNAN**—That is rubbish; they can load the price of other things. I think you are hallucinating.

**Prof. King**—You are welcome to your opinion, Senator Heffernan.

**Senator COLBECK**—I think we all get the pure economics of this although I have to say that there is already evidence that this is having a direct impact on farmers based on some of the supply agreements that they have with processors, particularly in Queensland. It goes back to some of the base issues of cost of production—you have mentioned those. Senator Xenophon is right, and our evidence is pretty clear, milk is a pretty inelastic product. I think what is concerning us and what is concerning a lot of people within the dairy sector is that this is about an economic shift in the industry towards Coles and away from other areas. What we are trying to manage through this process is the impact of that. I get the raw and pure economics. My perception of this is that you are talking about this much more in pure economic terms than perhaps with knowledge of the dairy supply chain which we have spent a bit of time hearing about over the last 12 months or so.

One of the important elements of this is what Coles’ motives in this are and Senator Xenophon has alluded to that. They are obviously trying to seek market share. I think you are right, this is a marketing campaign and it is about their market share and, in the longer term, control of the supply chain. What we are concerning ourselves with is the overall effects of that—what impacts that might have on some of the regional areas of the dairy industry where cost of production is higher. With respect to some of your comments about the impacts on dairy farmers particularly in the lower cost areas, Victoria, southern New South Wales and Tasmania, we understand that. In the context that you are coming at this from, should we be looking at the impacts of this and what it does to the shape of the industry in the longer term? I think the pure economics are obvious, but it is the effect and boundaries of those pure economics that we are trying to concern ourselves with.

**Prof. King—**I understand. I started on the farmers because that is where the debate has been. I think the critical feature that needs to be distinguished here is that the processors are likely to lose and processors' interests are not in line with the farmers' interests in this situation. I do not wish by any means to suggest that dairy farming is an easy industry or that dairy farmers have it easy.

Dairy farmers face a number of serious competition issues, particularly if they have only one processor that they can access for their milk. One of the main users of the collective bargaining parts of the competition and consumer law is dairy farmers so that they can improve their bargaining position with the processors. The processors are likely to be hurt by this. To understand why, you have to focus on the processors' strategy. The processors get their profit from two sources: when it comes from fresh milk, and they obviously get some from cheese, yoghurt, dry milk and so on. If we concentrate just on fresh milk, they get their profits from their own branded milk and, if they have a home brand contract with one of the supermarket chains, they get their profit from that as well.

**Senator COLBECK—**If in fact it is profitable.

**Prof. King—**They make a lot less, as I understand it, on the home branded milk than they do on their own brands.

**Senator COLBECK—**That is if that contract is profitable, and we had some evidence about that yesterday.

**Prof. King—**I suspect the contracts would be pushed to the bare minimum. If there was anything else happening, if processors were actually making significant profits from the home brand milk, I would be astounded. So I suspect they are making very little, if anything, from the home branded milk. What the Coles strategy will do is move demand from the branded milk towards the home brand milk. That will hurt the processors, undeniably. That by itself will not hurt the dairy farmers directly. Maybe I have a poor opinion of the dairy processors, but I do not believe the dairy processors are in the industry to do anything other than maximise their own profits, and they do that by pushing the price to dairy farmers down as much as they can. So, if there is less milk sold, that will be forced through into a lower price for dairy farmers via the processors.

What the processors will be facing is they will have to supply more milk, but more of it will be the milk that they make very, very little profit on, which is why I expect the price to go up for dairy farmers, because the processors will have to meet their supply contracts. I expect the profits of the processors to go down substantially as their branded milk sales drop.

**Senator HEFFERNAN—**Hang on. Are you taking into consideration here the switch to non-market milk, as opposed to market milk?

**Prof. King—**What do you mean by non-market milk?

**Senator HEFFERNAN—**Manufactured milk.

**Prof. King—**But why would lower prices for fresh milk lead to customers switching to manufactured milk? They would not.

**Senator HEFFERNAN—**Because of the global market. Your so-called headline here, ‘Sell cheaper milk and you will sell more milk,’ is garbage. You do not reflect the position of the subsidised milk situation and the protection of farmers overseas, and the great proportion of our milk that goes overseas, especially from northern Victoria, is manufactured milk.

**Prof. King—**As I said at the beginning, if the farmers are having their farm gate price set by the export market, which is dry processed milk and UHT milk, they will probably be completely unaffected by this.

**Senator HEFFERNAN—**But that—

**CHAIR—**Senator, may I just interrupt. Professor King, we have taken a document off your Core Economics blog. Can we have this tabled as a document for this hearing?

**Prof. King—**‘Milkonomics’? Is that the one you are looking at?

**Senator COLBECK—**There are two. There is ‘Milk headlines’ and then there is ‘Milkonomics’.

**CHAIR—**These are your blog postings. We will table those documents with your permission. Are you happy for us to table these documents and have them included in the record?

**Prof. King—**Yes. They are public documents. I am more than happy for you to include them in your record.

**CHAIR—**Thank you.

**Senator RYAN—**Professor King, I should confess at the start I am a former student of yours at Melbourne uni, but I do not think in a memorable way!

**Prof. King—**It is good to see that you have succeeded beyond any possible expectations, Senator Ryan.

**Senator RYAN—**Before my colleagues start interjecting, I would like to get a few things on the record and expand on a couple of things.

**Senator HEFFERNAN—**Professor King, did you do St George and Westpac at the ACCC?

**Senator RYAN—**You outline in the milkonomics blog posting that, as a response to the price difference, we are seeing a shift by consumers from branded and marketed milk to effectively generic or private label milk. Given that these are effectively the same product—at least that is what we have heard so far, although there are some questions about that—that can basically be seen as an increase in consumer welfare, can't it, because they are paying substantially less for a product that has a different label but is effectively identical to the one they might have been buying a month ago?

**Prof. King**—Yes. Someone in the background did mention the ACCC. I was one of three commissioners on the ACCC's grocery inquiry and, from that inquiry, the information as I understand it is that it is the same milk. So if consumers pay less for it there is gain there to consumers.

**Senator HEFFERNAN**—I was asking also were you on the Westpac-St George—did you do that?

**Senator RYAN**—You do not have to answer that, Professor King.

**Senator HEFFERNAN**—You can if you have the courage.

**Prof. King**—I am more than happy to. I said that I was involved in that decision when I gave evidence before the Senate inquiry into banking; it is on the record.

**Senator RYAN**—If we see that as an improvement in consumer welfare, that is basically a reflection of the fact that in some ways the consumer is being offered a choice and has some access to information they might not have previously had, in the sense that one product is cheaper than the other and they are effectively the same. What I am trying to get at is that this is being driven at the consumer level by people actually switching to buying cheap milk. If they wanted to protect the branded milk or the processors they could actually, if they so chose, pay for more expensive milk, couldn't they?

**Prof. King**—If the consumers wish to keep on buying the branded milk they could, but at obviously the higher price. That is where the substitution will come from: consumers switching from branded to home brand, and also increased sales as consumers may have been willing to buy something else—say, UHT—and are switching across to the fresh milk.

**Senator HEFFERNAN**—You've taught him to dream as well!

**Senator RYAN**—Senator Heffernan, I have just learnt that when people ask for exceptions from theories of economics, the consumer generally has to grab their wallet in the history of this country. So based on your argument, Professor King, it is no coincidence that some of the strongest arguments about the potential damage of this Coles pricing policy have been made by other milk processors, given that you outline that milk processors are probably the ones at the greatest risk here of losing profit margin?

**Prof. King**—Yes, I think that is exactly right.

**Senator RYAN**—One of the theories put to the committee about this has been that this is a temporary price cut and then afterwards, as the branded milks disappear, there will be price increases and the consumer will not have as much choice. We have three major players in the grocery sector plus a series of independent players. Do you have a view on the likelihood or possibility of that in the retail market for fresh milk?

**Prof. King**—I think it is unlikely. The reason I think it is unlikely is that it is a collusion type of strategy. Coles, Woolworths and Metcash—because you just simply would not be able to do it alone as Coles—would have to be following a strategy of being able to drive out the branded milks so that they could make more profit eventually pushing up the price of generic milk. That sort of thing is not infeasible, but if they were doing that then they would clearly be colluding and should be prosecuted under the Australian competition and consumer law.

**Senator RYAN**—And the fact that at the moment the Coles price cut was immediately matched by Woolworths and ALDI and some other independent players is actually a sign that we do have a degree of competition in the retail grocery sector?

**Prof. King**—Assuming they are not actually sitting in a smoke-filled room and colluding, yes.

**Senator RYAN**—Assuming there is no breach of the law, we do have competition in this market?

**Prof. King**—It appears so.

**Senator RYAN**—Thank you.

**Senator COLBECK**—To follow on from that, I would like to ask a question about the generic branding. Obviously that is a strategy that has been followed fairly successfully by a couple of supermarkets in the UK. I cannot think of their names now.

**Prof. King**—I believe Sainsbury’s is one of them.

**Senator COLBECK**—It is no secret that major supermarkets in Australia also have an objective of having a significant proportion of their product as generically branded. That is not a secret either. In the UK in particular they have been quite successful in capturing the supply chain. Again, this comes back to some value judgments that we put around the pure economics, which is what I was talking about before. If we are happy to do that obviously there are issues about consumer benefit that need to be considered as part of that overall process. But it is a matter of where we want the value chain wealth generation to be. Do we want it all to stay or to go to, say, a couple of major supermarkets who have the capacity to wrest control of that, or are we happy to have a broader and perhaps more competitive system into the longer term?

**Prof. King**—I am not sure what you mean by a ‘more competitive system’, so let us—

**Senator COLBECK**—I am talking about having more players. If you have got only two or three players in the market and they are harvesting value out of the market chain at a number of different places, which appears to me to be the trend, rather than having it more broadly managed.

**Prof. King**—There are the three levels—the retail level, where there is a reasonably high degree of concentration in the Australian grocery market, which you would all be aware of. Then upstream you are talking about the processor level. If you are suggesting that Coles is likely to backward integrate into processing, I am not aware of any examples off the top of my head where that has occurred around the world due to home brand or generic pricing of milk. What you would expect to see is the supermarkets running very tough, hard contracts to keep the processor profits down to their absolute minimum to be able to supply that generic milk. Then the third level of the production chain is back up at the farmers' level and, as I have already stated, if the sales of milk go up then the farmers must end up better off, because that is the only way you can get more milk.

**Senator HEFFERNAN—**The sales of milk will not go up. As it does now, any surplus goes to manufacturing.

**Senator COLBECK—**I think that is one of the issues here. If the farms are not going to get a decent price, they will switch to manufacturing, which is a lower return to farmers because it has a lower cost base. So there is potential for that move, or it is going to basically just transfer the supply around the market out of some areas and into the concentration of the supermarkets. I think that is probably the core of what we are talking about. This, as you quite rightly say, marketing campaign, is about transferring the supply of milk out of other supply chains into the Coles supply chain.

**Prof. King—**It is clear that, on the assumption that Coles is doing this to maximise its profits—and I think that is a pretty reasonable assumption for our supermarkets in Australia—yes, Coles will want to be selling more milk, making more profits from the grocery basket, from its campaign here. It will want more market share. The degree to which that simply leads to consumer gain as Woolworths matches it, as Metcash supplied IGA stores match it and as ALDI lower their price from slightly over a dollar down to a dollar to match it, how much extra profit ends up in Coles's pockets, I am not sure. But if they get a lot more out of it they may make very little, as competition works.

Is that a good or a bad thing? The consumer benefits, there may be some small losses to other retailers. That is an empirical question that I have got no data on and I am not sure that people have done the analysis to see how much the small corner shop will be hurt by this or how much the fact that they are selling on convenience at the moment means that they will still be selling on convenience. The idea that this would somehow then make consumers worse off in the longer term—I cannot see that, I am sorry.

**Senator COLBECK—**I think in Tesco's case in the UK there is a direct supply line from farm to supermarket in that circumstance. So that is one of the reasons that I have a view that that could be part of the process. Coles will put us right on that at some stage on that, I am sure. Thank you for your evidence, Professor.

**CHAIR—**We will conclude at that point. Thank you, Professor King, for your evidence this morning.

**Prof. King—**Thank you very much.

**Senator HEFFERNAN—**Have you ever been on a dairy farm? Any time, mate. I'll take you out.

[11.50 am]

**BROKENSHIRE, the Hon. Robert, Private capacity**

**CHAIR**—I now welcome the Hon. Robert Brokenshire. Would you like to make an opening statement?

**Mr Brokenshire**—Thank you, Senator Eggleston and senators, for the opportunity of appearing. I would like to give a brief introduction to my own personal situation so that it is on the public record. I would then like to talk about some of the comments that have been made by Coles to this point and then I would like to specifically talk about the South Australian situation regarding the move by Coles with respect to discounted milk. I also put on the public record that I am paired today from the South Australia parliament, and both the state minister and state shadow minister are aware that I am here and are pleased that I am appearing.

By way of background, I have a son at home who is a fourth generation diary farmer and is actually breeding from his great grandfather’s original stock. He was chosen, with 17 other leaders in the dairy industry in Australia, to attend a leadership program in Australia and New Zealand. My fear is that he may not be able to pass on the dairy farm to, if he has a son or a daughter, a fifth generation. Ironically our family came from the United Kingdom 170 years ago this year to farm in South Australia. Today we have, I understand, leaders from Coles that have come from that same country, the United Kingdom, on contract. I believe that—and the allegations could be checked—they are on significant contracts and significant bonus for getting profit to record highs for Coles. I understand it could be as high as a $38 million bonus that they will leave Australia. But we will be in an absolute mess when it comes to the dairy industry. The dairy industry is the easy one to pick off and it will flow through to all of the other food sectors. I am concerned that our food security is at risk.

There has been a lot of rhetoric, spin and misrepresentation, as I see it, from the media people within Coles. I am happy to answer questions on where I see that as spin, misrepresentation and rhetoric. The bottom line is that Coles are saying that they only sell five per cent of the white milk market in Australia. That may be so, but their decision has ramifications throughout the few other supermarket chains that are in Australia to the point where probably up to 50 per cent of white milk now is being sold under cost of production. The five per cent spin is just spin. Their decision has directly put at risk all of the white milk brands and the whole milk fresh brands.

I agree with what Senator Xenophon said, even though he may have been ridiculed by an export processor, that potentially—and I am not a drama king, but mark my words—we may well see the absolute majority of milk available on supermarket shelves as UHT. That is how serious this is. This is a $10 billion value added dairy industry to Australia that is at risk. In all my years in the dairy industry I know the fact is that you have to have a strong domestic market and a strong export market. The nonsense and argument that suits Coles that all farm-gate price is determined on export market is wrong, totally inaccurate and untrue. I can give you evidence going back where sometimes the domestic market underpins and supports Warrnambool Cheese and Butter and the Murray Goulburn suppliers of this nation so that they get some reasonable export price. At the moment the export price is helping but the domestic market must be strong or this industry goes. I want to table documentation that is specific to South Australia. I have 10 copies of the *South Australian dairy industry strategic plan for 2010*.

**CHAIR**—Does the committee wish to accept these documents? I accept them to be tabled as part of the record.

**Mr Brokenshire**—One is the strategic plan for the South Australian dairy industry and the second one is a letter that I received from National Foods regarding their earnings on white milk. The third is a document from the ACCC that, as a member of parliament, I am extremely disappointed about. I will go that in time. Finally I have one which I have not copied yet.

I did write, with quite a legalistic letter, to Coles asking them to give me a written assurance that this was not going to affect farmers at farm gate. Several weeks later I received a response, which I table. I just want to read two paragraphs from it and I would encourage senators in their busy workload to read the whole lot. In the response from Coles they say:

> Despite claims to the contrary, Coles is not out to hurt dairy farmers by cutting retail milk prices. The simple fact is that Coles does not buy milk from the farm gate. We buy processed milk from several foreign-owned dairy processing companies. These milk processing companies determine the farm gate price they pay to Australian dairy farmers.

Coles is starting to shift the argument from their promise and assurance that it would not affect farm gate to now blaming the processors if it affects farm gate. That is what Coles' tactic is today. We as farmers are price takers, not price makers, and we are getting done over with input costs at farm gate n otherwise. Of course, if Coles screw the processors it will come back to us at farm gate. I have seen it for decades.

The other point I want to raise is that they also say in their letter:

> While retail milk prices are available on shelf every day for everyone to see, we do agree that there is a lack of transparency about what milk processing companies pay Australian dairy farmers at the farm gate. Why processors have not passed on to dairy farmers some of price increase received from Coles at the start of 2011 is a question dairy farmers need to be asking their processor.

I put it to the committee: we need transparency from the supermarkets. We need transparency from the paddock to the plate, and I for one will not accept Coles now trying to blame the processors. I have to say that I am disappointed particularly with a member of federal parliament that I have a lot of time for and who was a very good minister for primary industries, and that is the Hon. Tony Burke. In a response he said:

> I do have some information here from the Minister for Agriculture, Fisheries and Forestry that lower milk prices should not be at the cost of Australian dairy farmers. I am pleased that Coles have publicly confirmed they are honouring their assurances that these price reductions would not drive down farm gate prices for dairy farmers.

They are, they will, and the evidence is there in that document, and I table it.

In conclusion, this is an article from *Dairy News Australia*. It says 'A low act', and it highlights the $2 for the home brand milk as against the private brand milk of $3.43. I think that editor has been extremely kind saying it is a low act. They have gone over the mark. Coles have overstepped the mark and it is unprecedented, in my opinion.

I admit that I am not a full-on deregulator or economic rationalist, like some members of parliament are. We need free trade, sure, but we need fair trade; I do not believe that we should be in a situation where other industry sectors have to be destroyed simply to drive up profits that we have seen in the first six months this year of Coles and their parent company, Wesfarmers.

Coming to South Australia specifically, I would like to raise three key points further to my written submission. As I said earlier, I sat around the cabinet table when the start of the dairy plan was developed. To their credit, the now Labor government took over from the Liberal government and the Premier himself endorsed that dairy plan. That dairy plan for South Australia was working very well. It completed in 2010 and delivered a lot. It could deliver a lot more and it is subject to review, but I suggest to you that the current government or any future government will not be able to deliver anywhere near what they have over the last eight years, because of this decision.

We have two factories at the moment: one at Murray Bridge and one at Jervois. They are up for review. We were hoping, with government support and multipartisan support, we may bring some new players into the market. The timing of Coles' announcement puts at risk those two opportunities and I suggest to you the decision will probably be to mothball them and those regions will lose hundreds and hundreds of jobs. Critical mass is important. Whilst we have been able to maintain that till now with less of us dairy farming—from nearly 1,500 when I was a young dairy farmer to about 300 now—the bottom line is we are tipping over. Our debts have increased. We cannot afford lower farm-gate prices.

The final point on that is that we hear other people giving evidence to the Senate saying that the south is okay because they are more into export. I would like to actually address that. Some of the southern states may be okay at this point—Victoria and possibly Tasmania, although they have already been doing it hard—but South Australia is absolutely focused and set up for the domestic market. It is going to hurt us big time. We will be, just like Queensland and New South Wales, in major trouble as an industry.

I will conclude with some suggestions to the Senate that we believe could be worthwhile looking at in recommendations. The first one is to revisit the Trade Practices Act. It is 10 years since they made a decision to take 49 out and we believe that 49 should go back in based on what has happened since and where possible that act, or whatever the new act is called, should be strengthened. We support and encourage investigation into antitrust laws like those in the USA. We call for a regulatory framework from paddock to plate. Coles touched on it, but it needs to be a regulatory framework so we can see what is happening with profits along the food chain from farm gate right through. It is possible that economic research is required on the thresholds at which a duopoly corrupts a market and requires intervention. I think it is time we had those powers because I believe this is corrupting the market and tipping it over. I argue that we have seen the crossing of that threshold and I believe that, unless the parliament and the government of the day seriously look at your recommendations, we will see not only the dairy industry but the food industry generally in Australia on a slippery slope. To quote Coles' logo, 'Down, down and staying down' is where food producers and the food industry will be in this nation. It is that concerning.

**CHAIR—**Thank you very much, Mr Brokenshire. I certainly think the idea of section 49 being restored or something similar to it is one that has been mentioned by a number of witnesses and the idea of antitrust laws is also something that several people have raised. I will invite your South Australian compatriot Senator Hurley to ask you some questions.

**Senator HURLEY—**Rob, you are a farmer in Fleurieu Peninsula area close to Adelaide and you have emphasised that South Australia is a different region to Victoria. Are there also different regions within South Australia? Is the Fleurieu Peninsula different from perhaps the south-east of South Australia, which is adjacent to the Victorian region?

**Mr Brokenshire—**It is slightly different because there are more producers now that have tapped into the Warrnambool cheese and butter Murray Goulburn processing plants, which are focused on export. So it is fair to say that some of them at this point are not under the pressure that the rest of us are in South Australia, but it suffices to say that the absolute majority of dairy farmers in South Australia are supplying National Foods/Dairy Farmers, which are now combined, and they are at big risk of a significant reduction in farm gate if this price war continues.

**Senator HURLEY—**We have also had some discussion about getting together and forming groups and bargaining that way with processors. Does that occur or is that not necessary at this point in South Australia?

**Mr Brokenshire—**We have appreciated the opportunity to bargain collectively. I put on the public record that I am a member of the Dairy Farmers Milk Co-operative, which is across the eastern states and South Australia—there are approximately 1,500 of us in that collective bargaining group. Suffice to say that, because of the pressures prior to this Coles decision, just after Christmas and just before this decision we were in mediation with National Foods. So there were already alarm bells ringing on the problems we were going to have negotiating our new contract as of June this year. That has been absolutely accelerated by the decision of Coles.

**Senator HURLEY—**We have just heard about what is happening to some extent in Europe, where there are some markets where not much milk is drunk, apparently. They have mostly UHT milk in their shops. Where there is a large amount of milk drunk, people prefer fresh milk, obviously—in my view. Australia is a large consumer of milk. It seems unlikely that we will go to UHT, but we may well go to almost total generic branding except for a few niche products. Do you have any intrinsic problem with that, provided that the price is right for dairy farmers?

**Mr Brokenshire—**I have serious problems with that. First of all, at $1 a litre, which is below cost, the price is not right. It is cheaper than water, as has been highlighted, but also I can tell you—and I am happy to show you in camera—my own farm figures. We use a computer program where we line ourselves up with others. It costs me 50c a litre to produce that milk at the start of the chain—50c a litre to break even. That is what we are getting now. But the dilemma that we have is that I know Coles and Woolworths. I have family in one of them, and I am not going to say which one, but I know what the agenda is. It is to have the absolute majority in Coles and Woolworths as home brand and eventually only small volumes of private labels of any product.

What underpins the domestic market now is a private label cheeses, creams, yoghurts and all those other things. The private labelled milk is where the slight profit is. What worries me is that, as it all goes to home brand, those other products will diminish too. They are already trying us on home brand cream and butter, and it is rumoured they may take us on with home brand cheese too. Once that happens, you wipe out the opportunity for a reasonable return unless the processors can get enough money out of Coles. They were offsetting selling at cost on home brand because they did have a margin in private brands, which I have just tabled information on. Having said that, they only have played two per cent margin is processors. Coles tell me, ‘Robert, our earnings before income tax are four per cent.’ Ask the processors what their margin is, because I think it is less. I can tell you that farmers at the farm gate do not have that luxury of four per cent return on our net investment at all.

**Senator HURLEY—**So you do not believe, as Coles have intimated, that it is the milk processors that are getting all the profits and squeezing the farmers? It is not the middle man making the money?

**Mr Brokenshire—**I would like to see a regulatory framework from paddock to plate so will we can see what are fair and reasonable profit margins for Coles, Woolworths and supermarket retailers and for processors. Where will show you what the farm gate price reasonable is or should be. A lot of the time now it is not there. The processor is being screwed right down on the price. The reason why processors over the last five years have sold home Brand milk at cost or below cost, which has hit us, is so they could get the rest of their private labels and value added products into the supermarket chain. They have two be able to actually deliver back to farm gate, and if they are getting screwed down it comes back through to us. I have seen it for the last five or seven years as this has been accelerating.

**Senator HURLEY—**You have tabled the strategic plan for the South Australian dairy industry, and a lot of productivity improvements have been achieved over the years through efficiencies with automation and that sort of thing. Do you think there is enough to be made in gains there that would enable you to live with those prices, or is that an impossibility?

**Mr Brokenshire—**I would like to think my son and his generation are brilliant Australian farmers. They have got diplomas, they are no fools. But we have gone as far as we can on that. In order to go slightly better with robotic milkers, which would be our only other opportunity, and for robotic milkers you are talking $1 million just to set up in one robotic milker, we would need three. We cannot invest and borrow another $3 million if we are not getting the break even price at the farm gate. I will conclude the answer by saying that my father-in-law was a director of the Dairyvale cooperative in Adelaide, South Australia and I know how tough it was for them to break even is a cooperative delivering any profit back to us as farmer shareholders. It was hard enough then. That is why they eventually had to sell out to dairy farmers and that is why dairy farmers now have been sold out to National Foods come Kirin in Japan. I think we are pretty smart, efficient industry but a business that we will get smarter, get more efficient, breed more hours, that just does not work. We are at that point, from 1500 to 300 dairy farmers. When I was a kid we were viable on 60. Now I have got 300. That is where we have gone to, and now we are back to where we were with a 60 when it comes to trying to get a margin. It cannot just keep growing like that. We need to be able to consolidate and get a reasonable return.

**Senator XENOPHON—**Thank you for your submission. I think you alluded to some material you could give us camera and we might take you up on that. It was an issue that you could discuss with us confidentially in a moment, and obviously that is for the committee as a whole to decide.

I go to the response from Chris Mara, adviser government affairs corporate affairs for Coles. He is saying that Coles is not out to hurt dairy farmers by cutting milk prices. You made reference to it, that Coles gets the milk from processors. Mr Mara's letter says: 'I can assure you that Coles has made every attempt to prevent its retail price reductions having any flow on impacts at the farm gate.' What do you say to that? You may have heard evidence from Professor Stephen King, the economist, earlier. What is your response to that, saying that the market is going to grow or that it will not make any difference because processors will give you the same amount?

**Mr Brokenshire—**I do not see, unfortunately, a lot of growth in the amount of whole milk consumed by Australians per capita. It is pretty steady; if anything it has actually dropped back a little bit. I do not buy Coles' argument at all because they are manipulating the truth. Yes, until we get our next contract renegotiation it is not going to affect us at farm gate in South Australia. However, Parmalat in Queensland has already been affected—

**Senator XENOPHON—**Because their contracts allow that with less branded milk they can actually get paid at a lower rate for tier 2.

**Mr Brokenshire—**Correct. We are now on tier 1 and 2 and it remains to be seen whether they do not even start to try to play games with the contract that I am on with National Foods because of the pressure they are under before 30 June. But certainly where Coles are misleading the situation is once the new contracts are made if the processors have not got a reasonable margin there to run their business they are just going to do us over at farm gate and we will be pushed down lower and lower with our farm gate price. I make it very clear that Coles are wrong in saying that their initiative is being absorbed and that it is going to not affect farm gate. They are not absorbing $30 million a year and the consumers of the product of milk may at this point enjoy a cheaper product but in the longer term they will be paying through the nose for it.

**Senator XENOPHON—**I am interested in getting you to give evidence in camera because you made that offer and it is up to the committee to do that. But from the dairy farmers that you speak to, your fellow dairy farmers in the Fleurieu Peninsula, what feedback are you getting? How close are some of them to the edge to say, 'It's just not worth it. We will do something else for a living,' or as Senator Heffernan says, 'We will sell the cows to the abattoirs or whatever and that will be it'?

**Mr Brokenshire—**It is getting very close. In camera I would be happy to tell you specifically why but, firstly, financially it is too tight because with seven years of drought we have all extended our overdrafts and borrowings like you would not believe; secondly, the banks are not as friendly at the moment because of the increase in debt and, thirdly, mentally it is tipping over my colleagues in the dairy industry. What Coles have done here is blowing their brains because this is unprecedented. With all the other stresses we have had to endure as farmers, most of them are now on the edge. They are on the point of seriously giving up.

**Senator RYAN**—You said you wanted a regulatory framework from ‘paddock to plate’, I think that was the phrase you used. What do you mean by that? Are you talking about price, access to private information that is not accessible elsewhere or floor prices? What are you talking about there?

**Mr Brokenshire**—I will try to explain it. Senator Ryan, someone like you, who has done an economics degree, may be able to help more. I will give you the layperson’s—

**Senator RYAN**—I did not do an economics degree. I did study under Professor King, but I did an arts degree.

**Mr Brokenshire**—I will try to give it to you as a layperson. I really need you senators, with what you can tap into, to develop the model if you could consider it. Whether the price of milk at the farm gate is going up or down, we can see trend indicators, indicative prices and where the world spot prices are at any given time—that is available. You will see in the Coles’ response that they did not answer most of my legalistic letter because they use the protection of commercial-in-confidence. I think the industry sector has gone over the top in using commercial-in-confidence. There is now a lack of transparency.

If the market goes up and the processor is able to get 15 per cent more for its whole milk powder—and part of what we are supplying is raw milk—then I want to see how much of that 15 per cent they actually return to us. Yes, they have to make a profit and it has to be free and fair trade, but I never know. They may make $1,500 a tonne extra out of whole milk powder and we may get 1.5c a litre out of that, but we do not even know whether we are getting that.

**Senator RYAN**—This information is not available in other sectors of the economy. The government does not regulate the publication of effectively private contracts. That is one issue. When you say you would be interested in the information, are you also saying that, if there is a spike—for example, $1,500 a tonne increase in milk powder that you mentioned—there should be a guaranteed share of that coming back to the farmer, or do you just want access to the information about what happens?

**Mr Brokenshire**—At the least I and my colleagues in the dairy industry would like access so we can see some transparency. Then I guess it is up to us to be able to drive our argument based on some knowledge. A share of that would be brilliant, but I do not think they are going to give us that.

**Senator O’BRIEN**—I suggest that, if you are involved in bargaining, these are the sorts of issues thaat dairy farmers ought to be bargaining about.

**Mr Brokenshire**—I totally agree, but there is one problem—they say, ‘We can’t give you that information,’ ‘We won’t give you that information,’ or, ‘We don’t have to give you that information.’ That is our dilemma. If we had that information, it would make it much easier for us to bargain. We are bargaining pretty much blind—seriously.

**Senator RYAN**—Given that we do not regulate that sort of information in other sectors of the economy—and my apologies if this is an obvious question—what is so special about dairy that says that there should be legislation effectively interfering in private arrangements and private sector activities? Why should we do that in this sector if we do not do it in other parts of the food chain or the white goods retail sector, for example?

**Mr Brokenshire**—If you are in white goods and your cost components for manufacturing that washing machine go up, you add that on. You say that you are going to take a 15 or 20 per cent margin. Harvey Norman has a margin. We do not have a margin opportunity. By the way I am not only talking dairy industry; I am talking paddock to plate for the food industry. We should remember that in the global financial crisis it was actually not mining but agriculture that kept us out the saga, plus other initiatives that the government put forward, I acknowledge. In South Australia last quarter the only thing that kept us going was agriculture. So it is still the most sustainable industry in a hungry world that is getting hungrier.

I am putting my hands up and saying that I believe we have gone too far. We do need some regulation and we do need some transparency. The free traders, the deregulators and the economic rationalists went too far. Surely they can see their mistake.

**Senator RYAN**—As one of those, Mr Brokenshire, I could say that one of the reasons that agriculture is doing so well is precisely that we have taken it that far. I would respectfully challenge your view that other retailers have the ability to do cost-plus marketing, knowing some sectors the way I do. For example, with books they can no longer do that, because I can hit up Amazon or The Book Depository and buy. So many more sectors of the Australian economy are now exposed.

**Senator HEFFERNAN**—You cannot buy fresh milk over the Internet, though.

**Senator RYAN**—No, but the point I am making is that there are many people involved in retail who are price takers.

**Senator HEFFERNAN**—You are dealing with a perishable. You cannot eat and live off a book.

**Senator RYAN**—But that is the only point I would make. I appreciate your answer. I now understand the point you were putting.

**Senator HEFFERNAN**—If the world market was where it was two or three years ago and Coles pulled the stunt they have pulled now—and they have put a side bet on by saying, ‘The global market is all right’—it would have been the clean end of it, wouldn’t it?

**Mr Brokenshire**—If there was not a strong export market right moment it would be the clean end of it. If this had happened three years ago—and, I would suggest, most years in the last 20—because of the yoyo effect of the export market, the industry would be on its knees, if not gone.

**Senator HEFFERNAN**—For sure.

**Mr Brokenshire**—Wheat farmers can put it in a plastic bag, Senator Ryan, and store it. Wool they can store. With paddock to plate fresh product we cannot do that, sir. That is the dilemma. We need a little bit of honesty, transparency and credibility in how we can then negotiate. I am not asking you to give us total protection or anything like that. Those days are gone, if they ever were there. I am asking for some transparency.

**Senator HEFFERNAN—**Just watch JBS Swift do the same to the meat market.

**CHAIR—**We will now proceed to hear evidence in camera.

**Evidence taken in camera, but later resumed in public.**

*Evidence was then taken in camera but later resumed in public—*

[1.43 pm]

**MOSS, Dr Neil, Senior Consultant, SBScibus**

**STRONG, Mrs Lynne, Co-owner/operator, Clover Hill Dairies**

**CHAIR—**Welcome. We are little late but we finished a little late too, so we apologise for any inconvenience caused to you. Your submission to this inquiry has been numbered 53. I invite you to make an opening statement.

**Mrs Strong—**Thank you. My family and I own Clover Hill Dairies at Jamberoo on the New South Wales south coast. We thank you for allowing us this opportunity to share our story. Whilst the Clover Hill Dairies submission covers a broad range of issues, I would like to focus today on my area of expertise as a farmer and comment specifically on farm gate, wholesale and retail prices.

Firstly, I would like to make the following triple-bottom-line comments. From an economic perspective, Australian farmers need and deserve to see a bright future to ensure continuing resilience. Dairy farmers who supply the fresh milk market have battled deregulation, and they won that one. They have survived 10 years of drought, they have been devastated by floods and now the industry's future viability is threatened as a result of a marketing campaign dreamt up by the big end of town. Not surprisingly, Australian dairy farmers are waking up every morning wondering what new battle they will have to face. Worse still, this one is man-made.

From a community perspective, the community must be able to see a bright future for our industry so we can maintain and increase our ability to attract the best and the brightest. On top of this, consumers today have high expectations, and quite rightly so, that the food that they buy will be produced on farms with high standards of animal welfare and environmental protection. They want food that is produced in a way that meets or exceeds those consumer expectations. Coles' attack on milk price is seriously threatening this consumer right. Also, farmers must be able to bridge that rural-urban divide to share stories and build relationships with consumers so that consumers will value the milk that we produce and the farmers that produce it. I believe no-one should feel that they have the right to undermine this in a blatant attempt to increase their market share.

By way of introduction, my family and I milk 400 cows three times a day at Jamberoo on the New South Wales South Coast. Whilst our farms are only two kilometres apart, the topography and the climate are very different. Clover Hill is nestled in very steep high-conservation value rainforest on the north-east face of Saddleback Mountain and it is 100 hectares. Lemon Grove Research Farm on the other hand is situated on a flood plain. It was set up to diversify our business in 2008. Not only do we milk cows at Lemon Grove Research Farm; we also conduct agronomic and pharmaceutical milk research. What our two dairy farms share in common is a high urban-rural interface. Clover Hill is part of a dairy-centric rural-residential subdivision of 12 blocks, ranging from 0.4 to 40 hectares. Lemon Grove is located directly adjacent to the Jamberoo township. So not only do the thousand people who live in the village see our farming practices every day, so too do the tens of thousands of people who drive by on the highway each year.

In 2000, prior to deregulation, our business was a one-man operation. Today we are proud to say that we employ 10 people. We graze twice the industry average of cows per hectare to provide five times the industry average of milk per hectare, with a water-use efficiency of 10 times the industry average per hectare, 35 times the industry average of water use efficiency per litre of milk produced, and our cows are believed to be the highest producing cows on pasture in the world. All of this on just 110 hectares.

Our strategy has been to increase milk production using fewer resources, generating less waste and reusing the waste that we do generate, and it works. We have been able to fence of 50 per cent of the home farm for conservation purposes. Today, over 80 per cent of the prime agricultural land in our region is owned by rural lifestylers. We have seen this as an opportunity. We now lease over 75 per cent of the land we farm on. Our business can be successful in this environment because we are committed to building cross-community partnerships and cross-border partnerships to secure our social licence to operate and our right to farm. Beyond the farm gate, we are highly committed to building lifelong relationships between rural producers and consumers. I am lucky enough to chair a network of young people called Dairy Youth Australia. With the support of our funding partners, we deliver self-managed events and activities that focus on youth, careers, the environment and the arts, and link all of these back to agriculture.

Innovative programs like the Archibull Prize use creative arts and multimedia to celebrate the role that Australian farmers are playing in feeding the world. The average person does not even consider the resources required to keep Sydney well fed, let alone six million people. Our programs tell this story. They build a bridge for farmers and communities to reach out to each other to share stories and improve understanding and work through potential issues together. Our programs also help build the capacity, which is so important, of young rural people to farm with resilience and confidence. Most importantly, our programs create the necessary sense of urgency in the community. Six billion people will soon become nine billion people, and the next generation is going to have to decide how to feed and house all of these people on a declining natural resource base. We believe our programs help to provide our children with the tools to make the best choices.

We are very proud to say that Clover Hill Dairies is playing our role, like all Australian farmers, in feeding 60 million people. We are proud to say that we are playing our role in assuring Australians that agriculture is alive and well and it is a great career choice for their children. Excitingly, the programs that my youth group are working with have proved that young people do want to work in our industry. As I said, our farm employs 10 people, and the average age of our team is 25.

Farmers are competing with other industries to attract the best and the brightest, and this pricing war is directly undermining our efforts in this area. What young people want to have a career in an industry that’s future viability is threatened, as I said earlier, as a result of a marketing campaign dreamt up by the big end of town? This type of pricing war is detrimental to the future growth and sustainability of not only the domestic milk industry but also the export trade as it potentially undermines the very foundations of our industry. This is capital investment and human resources.

Sadly, at the moment, it just flies in the face of common sense. Demand for dairy products globally has never been higher and it is increasing. The dairy industry should be encouraged and it should be ready, willing and able to ride this wave. Australian dairy farmers will increase production to meet this demand if the pricing signals are right. Increasing production requires long-term capital investment, innovative ideas and practices and highly skilled labour.

Beyond the farm gate, we believe the milk price war is short-term gain for price conscious customers and Coles market share and it is long-term pain for Australian consumers and the wider international communities that Australian farmer supply. The unsustainable pricing of house brand milk leads to an inevitable removal of branded products from supermarket shelves. Eliminating competition means choice for consumers becomes a thing of the past. Consumers will be corralled towards house branded products sourced at the cheapest price and then sold with maximum margins. Competition is critical in any sustainable market. The government should not and must not allow milk and dairy farmers who produce it to be collateral damage in a war between retailing giants.

We believe the answers to this problem are relatively simple. We must have well-informed policy and decision makers and consumers making wise choices. We must have farm production systems that are ethically grounded, scientifically verified and economically profitable. We must have markets and pricing that reflect both the commodity value of farm produce as well as its environmental, social and animal wellbeing values. Continuation of this milk price war forces farmers to consider economics only. Animals, the landscape, the environment and people and communities will suffer. This is certainly not a world where my farm team want to farm.

In summary, we ask you for true leadership by our policymakers and decision makers. We need our policymakers to ensure that competition and fairness are driven at a national level. There must be a constant and proactive focus on improving competition within Australia’s supermarket sector. We ask for fair rules and we ask for fair conduct. We need our regulators to enforce their rules and, where the regulatory structures are deemed insufficient to deal with these issues, to suggest changes. We ask for genuine price transparency along the supply chain and an open dialogue between major retail supermarkets and farm producers on regional supply and demand issues.

In this way, we will be able to have strategies that will ensure that affordable, nutritious and sustainable supplies of fresh milk, drinking milk, can be delivered daily to consumers across Australia through a range of retail outlets. Consumers just want fair trade milk in their fair trade coffee.

Neil Moss, our farm consultant, can give you a broader perspective on what is happening in the wider farming community.

**Dr Moss—**I will speak briefly and add to what Lynne has had to say. I am a veterinarian and a farm consultant working principally in the dairy industry. I have been working with dairy farm businesses to improve productivity for over 10 years in this role. Prior to that I had a role in clinical and private veterinary research and veterinary practice, in both university and private practices throughout New South Wales. I now work with a very diverse range of dairy businesses. They vary in size from 120 to 1,200 cows. They are spread geographically, from Wauchope to Bega, from the Illawarra to Dubbo, Wagga Wagga and the Hunter Valley. My clients supply milk to Norco, DFMC, National Foods, Bega Cheese, Hastings Co-operative and Fonterra.

Our business employs four other professional consultants, two research scientists and three administrative staff. Our business is intimately linked to the dairy industry as well. Our broader client base stretches from South Australia through the Western District, Gippsland and northern irrigation areas of Victoria and to Tasmania and southern Queensland. We consult the farms that supply milk for both the fresh and the manufacturing milk markets. We have consulted in the USA, New Zealand, China, South-East Asia and South America. I am here today to provide some technical support for Lynne Strong of Clover Hill Dairies. It is a farm that I have been lucky enough to be associated with for over 10 years.

From my perspective, the recent decision by Coles and subsequent competitive responses from other retailers is a major concern. Overwhelmingly, this is the burning issue of conversation with our clients on farm—it occupies up to half of our consultation time at the moment. The market aggression that we are seeing is further eroding confidence in the industry, and there is little doubt in the minds of my clients that the farm gate price must eventually be adversely impacted. We are already seeing evidence of this with current negotiations between farmers and milk processors. This will affect farming businesses and families in many ways. Farm gate prices are already falling for those supplying drinking milk. I have some additional literature here to supply to the committee with some evidence of that.

**CHAIR**—If you would like to table the documents, please ask.

**Dr Moss**—I would like permission to table the documents.

**CHAIR**—Yes, the committee agrees to that. Thank you, Dr Moss.

**Dr Moss**—This is a price announcement from 23 July 2010 generally circulated to the supply base of DFMC. Further price drops are programmed into existing contracts, and these can be seen in the documents tabled.

In addition, tier 1 volume allocations have been dramatically cut in Queensland and are likely to be reduced for many dairy farmers in New South Wales as well. Recent returns to profit on farms following many years of drought are set to be reversed. Erosion of profitability will encourage many to exit the industry. We are already seeing this decision, in combination with the price and contract deliberations between DFMC and National Foods, erode farmer confidence. Farmers are contemplating exits in response to this. The ongoing stress this is causing is a major contributing factor to the number of my clients considering exit from the industry in the very near future. In the last month I have been involved in development of exit strategies with two highly viable progressive farmers. They are lifetime career farmers. They are not ready to move on, but it is getting to them.

The exit of farmers from the industry, particularly those in proximity to major centres of the milk consumption, will eventually force up the price of milk. Milk will need to be sourced from elsewhere to cover the deficits that will eventuate. This is already occurring in late summer months, autumn and early winter in many regions. Climate variability and events such as the Queensland floods have exacerbated this situation. As farmers and milk production leave these areas, supporting infrastructure and services will decline, processing capacity will be reduced as volumes for factories decline, rendering them unprofitable.

We will see more situations such as we did in Queensland were milk during the floods was trucked in bulk to Sydney then trucked back in cartons for sale in Queensland markets. This will greatly add to the carbon footprint of Australian milk production and consumption as milk is forced to travel large distances from cows to processors and on to retailers for further sale. Major supermarkets in northern parts of New South Wales and Queensland will be forced to ship liquid milk all the way from Victoria rather than source it locally, as local supply is further curtailed through unsustainable supermarket pricing.

Rural landscapes and the environment will suffer. A large proportion of Landcare and on-farm environmental projects are funded by farmers. As profits and margins are eroded, this often discretionary spending with long-term benefits to all will need to be slashed to allow short-term survival. Animal welfare may also suffer as farmers are forced to slash spending on animal health, move towards riskier feeding practices and reduce spending on essential repairs and maintenance on things like laneways and tracks that allow cows to move around farms in safety and comfort. Human safety and employment may suffer as farmers are forced to reduce employed labour and take on even longer hours themselves to maintain profitability.

I have many clients at the moment that work over 80 to 100 hours a week. This is only going to be worsened as more labour is forced to be let go while these farmers take on the load to remain profitable. Jobs will be lost on and off farm. Clover Hill Dairies is a shining example of how a sustainable milk price can allow businesses on the peri-urban fringe to prosper. Animal wellbeing, the environment and staff and owners are all able to be ethically and sustainably managed while being on the very doorstep of Sydney. The future of this and many other model agricultural enterprises is being placed at serious risk by the behaviour of our major retailers. Thank you.

**CHAIR**—Thank you. I will ask Senator Ryan to begin because he has to catch a flight to Melbourne.

**Senator RYAN**—My apologies in advance for leaving after my questioning. I do not mean to be rude, but I have to get that flight. Dr Moss, I want to clarify a point you raised there, where you expressed a concern about milk being trucked up from, say, Victoria—it would most likely be trucked up—and the loss of local dairy farming. I appreciate that dairy has already been through a very difficult adjustment phase. The economy never stops adjusting. Are you suggesting—and please say if you are not; I do not mean to mischaracterise you—that we should be looking at the pricing of milk to maintain dairy farming in every area of Australia where it is currently being undertaken?

**Dr Moss**—I think that we need to look at the long-term costs of trucking milk and weigh that in context with those issues. If we take a short-term approach to things and remove industries now from local production and then move to shipping, in time we will find that those costs of transport—the direct rises in fuel costs in addition to the carbon footprint associated with shipping that milk those long distances—are going to be factors that we need to consider with respect to maintaining those businesses.

**Senator RYAN**—I am happy for the market to have different labels about carbon footprints, but I have to admit I am not going to approach competition policy from a carbon footprint point of view. That is something for producers to work out. I take your point. I am not going to argue with you, other than to say that I take a long-term view and have a different answer. The long-term view does not necessarily mean maintaining current activity in every place where it is currently happening.

**Dr Moss**—I think we have seen that arise to a degree already. With respect to long-term availability of milk supply in proximity to where it is being produced, for liquid milk, as we see increased pressure on our manufacturing milk with increased demand from overseas, over time we will find that that demand for locally produced supply will return. The issue is whether or not you will be able to re-establish those businesses in future years once they have gone from those environments.

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**Senator RYAN—**We heard from a witness on Tuesday that, in very broad terms, the price of milk in Victoria effectively reflects the export price, given the huge volumes from my home state that get sent overseas, and that up the eastern seaboard to a particular point the price, in very rough terms, reflects the Victorian price plus the cost of freight. If that is the cost of milk then, knowing that it is cheaper, effectively, the further south you go, I am yet to be convinced that what Coles are doing, followed by Woolworths, Aldi and others, is automatically going to hit the farm gate in the contract price being paid. I take the point about the tier 1 and tier 2 pricing and how that can flow through, but that is effectively a product of the processors' contracts with dairy farmers.

**Dr Moss—**Yes. I think that those prices in northern zones also reflect the additional costs of production associated with producing year-round at a flat line—

**Senator RYAN—**Security.

**Dr Moss—**And security around productivity. There are certain features of the southern market that do not allow that to happen either, in particular its reliance at the moment on Mediterranean rainfall patterns associated with winter and spring rain. Once again, there are times of the year in southern markets where the costs of production are extremely high. As we go forward, the ability to produce that milk locally will be very important, because the production costs in the south will come under increasing pressure as well.

**Senator RYAN—**Potentially, although I suppose that is a contestable issue.

**Dr Moss—**Absolutely.

**Senator RYAN—**As a general rule I do not have a fear of goods being moved around. I enjoy fresh produce that I know is not grown anywhere in my home state. Mrs Strong, it will not surprise you to hear that the challenge for the witnesses and for the committee is, effectively, to nail down something that can be done, and we have different views. We have had people talking about reintroducing the old section 49 of the Trade Practices Act. That will not necessarily help farmers at all, quite frankly; that is just going to help independent retailers get access to milk at the same price that the big chains do. Just playing devil's advocate, as is my natural place, what specifically are you looking at in terms of a government or legislative response? Someone has proposed a floor price, which would not surprise you, but it is not something that I particularly support. Someone went so far as to propose re-regulation. Others have proposed transparency in the pricing arrangements between farmers, processors and retailers. What do you think could be done to address your concerns?

**Mrs Strong—**From a personal perspective, if you asked me for one key thing, I as a farmer would like to see transparency in the supply chain. At present, the tendering process for milk for

Woolworths and Coles is basically a race to the bottom. The processors are just putting in a price, as low as they think they possibly can go. That obviously has to flow down the chain. Because of this lack of transparency in and focus on the tendering process so they can get product on the shelf, there are no supply and demand signals back to the farmer, and farmers, especially dairy farmers, need to make—

**Senator RYAN**—What do you mean by ‘supply and demand signals’ in that sense?

**Mrs Strong**—For example, two years ago, we were getting paid 5c a litre extra to produce more milk. As you can see, I have a document that I will tender later on, with your permission—also in my submission. We were promised we would be told the milk price going forward for 2010-11 in December. Because National Foods and Dairy Farmers, who I supply, cannot come to an agreement, it is likely that I will be given a price on 15 June and made to sign a contract by 30 June. So you have farmers who have to make a decision about million dollar businesses in a two-week time frame. This is exacerbated by the fact that nobody knows what is going on in the supply chain, and that has never been more highlighted: Coles is saying this, National Foods is saying this and the farmers are saying this.

**Senator RYAN**—We do not do that in other sectors of the economy, and a previous witness outlined, as did one of my colleagues at the table, that the reason it should be done here is that it is a perishable product. That makes it unique. So, because we do not do it elsewhere, it would be a very big step to force the exposure of private, contractual arrangements.

What I do not understand is this: even if there were transparency, how does that stop National Foods or whoever saying to a farmer on 15 June, ‘Here’s your price; we want the contract back by 30 June’? Transparency is only the supply of information—unless we were after a regulated approach to the relationships between processors and farmers or between retailers and processors. I do not want people to be disappointed by transparency—

**Mrs Strong**—It would allow us the knowledge bank to be able to actually go in and bargain competitively, for instance. In the situation that we have at the moment, National Foods are saying, ‘We have a two per cent margin.’ It makes it very difficult then, in a collective bargaining situation, to turn around and say, ‘Well, that’s not true.’ We have no idea whether that type of thing is true.

**Senator HEFFERNAN**—They could be pulling your leg and you would never know it.

**Mrs Strong**—We would not have a clue, yet—

**Senator RYAN**—I suppose a lot of other suppliers to major corporates do not have that information either.

**Mrs Strong**—My understanding is that, working with boutique producers, for example, they go in, they put their books on the table and Woolworths put their books on the table. This is very common with a supplier to Woolworths or a supplier direct to Coles arrangement. They just put their books on the table. ‘This is what I need to survive; this is what I need to make my business sustainable.’

**Senator RYAN**—None of that would stop Coles selling milk at a dollar a litre. One of the points you mentioned was that that is inevitably going to put pressure on the farm gate. I do not know that anything you have proposed there would stop Coles selling milk for a dollar a litre.

**Mrs Strong**—At least it tells us who is actually benefiting from the supply chain. Coles is making many statements that say, ‘Nobody is going to lose,’ but we do not actually know if anybody is losing here—

**Senator HEFFERNAN**—You do not know what the rest of the market is doing.

**Mrs Strong**—We have no idea what the rest of the market is doing.

**Senator HEFFERNAN**—It is the same in South Australia with the new wheat conglomerate. They know what is in storage everywhere but the other buyers and sellers do not get access to that information; therefore it kills them.

**Mrs Strong**—It does.

**Dr Moss**—One of the other things, which we often miss with dairy farming, is that the time frames for business planning are so long. As Lynne previously said we were given some very strong price signals three years ago to grow business with incentives from all the milk companies to produce new milk. That led to a very large wave of investment and leveraging to do that because there were strong signals in all markets that milk was growing to say, ‘Here is additional money for you to produce more milk over and above the milk that you produced last year.’ Those investment decisions have three, five, 10 year turnaround times to get returns. On top of that the actual programming of decisions that we make with herd management and milk production in the short term have minimum 12-month turnarounds. But having no information that we can actually rely on it makes business development in this market next to impossible.

**Senator RYAN**—I take your point. I suppose the hurdle I have to leap is why dairy as opposed to the many other industries that have the same constraints. You have explained your perspective on that. I have one last question. I asked this of National Foods yesterday because it struck me as odd that they were complaining about this and yet they supply the product. We have processors complaining about the damage that generic milks, private label milks discounted, are doing to the industry, to you as farmers—they do not seem to mention their own interests but we know that they are there—yet the product is only there because they constantly supply it. The processors are not compelled to supply milk to Coles for less than $2 for two litres.

**Mrs Strong**—Who is their other market? We have National Foods with a billion litres, if they do not supply Coles and they do not supply Woolworths, who are they going to sell that billion litres to? You do not turn round overnight and become an exporter. That takes major capital investment.

**Dr Moss**—I would like to table another document. This is an analysis from Fat Prophets on Wesfarmers and it gives an interesting external perspective.

**CHAIR**—We have had a request to table this document and we agree.

**Dr Moss—**It is interesting to get an external perspective from a stock market analysis company.

**Senator HEFFERNAN—**If anyone intimidates you, other than this bloke here and he is not very intimidating, because of evidence you give today—and I have an instance of a dairy farmer who is a supplier to one of the three processors who has been told they will no longer take his calls and also a milk vendor—will you let us know?

**Senator RYAN—**If anyone does that, that would be a very serious issue for the whole Senate which I assure you the Senate itself would take very seriously, completely across any consideration of issues whatsoever.

**CHAIR—**Threatening a witness to a Senate inquiry is a breach of privilege and the Senate can take very strong action against any person who does that. If you are threatened then please let the secretary know and we will report the matter to the Privileges Committee and the individuals concerned will have to suffer the consequences of the law. It is totally illegal to do that.

**Dr Moss—**Thank you. I will read this short section:

Coles has launched an intriguing lunge for market share in recent weeks. Not content with treading softly, it has ripped a large chunk off the price (about one third) of its house brand milk and is now selling it at roughly $1 per litre. As milk is a key staple item and finds its way into nearly every shopping trolley, it will have an outsized effect on shopper behaviour. The same can be said of bread.

The move has obviously angered Coles' big suppliers who are squealing loudly about the threat to their own profit margins. But it is interesting to note that there may be little they can do about the situation. If National Foods/Dairy Farmers wants to take its business away from Coles as its main supplier of house brand milk, who will they sell it to instead?

**Senator RYAN—**If it is so critical to Coles or Woolworths, it is a two-way street. They have to have that stuff in their supermarket, otherwise people will walk over the road to Woolworths, Aldi, IGA or anyone else. There are not many people that can supply the volumes of milk that Coles and Woolworths need.

**Senator HEFFERNAN—**It is consolidation of the market, both the processing and the retail.

**Senator RYAN—**Just let me finish the point. It has been put to me that the reason suppliers do this is: 'If we don't do it, someone else will.'

**Mrs Strong—**Can I as a farmer make a comment on that? We are talking about a perishable product. We are talking about animal well-being here. So National Foods says, 'Okay. We're not supplying you,' but they have got nowhere else for that milk to go. The first day it goes into Sydney Harbour. The next day they say to their farmers, 'We're not getting paid, so we're not paying you.' But every day we get up three times a day and milk cows straight up for animal welfare. What do we say to the cows? Where do we tip our milk until Coles and Woolworths—

**Senator RYAN—**I think the farmers in my home state when I was growing up tipped milk out because of a problem with the milk market there.

**Mrs Strong—**I can understand that, but it is different now. We produce five times the amount of milk we produced in 2000. Our cows are under pressure. I am not going to do that. I have been approached to do that in the past. I will not do that to the people who get up every day and work for me. I will not do it to my cows.

**Senator HURLEY—**I would like to continue in that vein. You say on page 8 of your submission:

In the region in which our farmers operate they are forced to supply LNNF through DFMC even though Bega Cheese collect milk from dairy farms 15 kilometres away and Parmalat process milk in Sydney which is only 90 minutes away.

Can you explain to me why that situation has come up; why are you forced to do that?

**Mrs Strong—**In the marketplace in which we operate, the major processors are major clients of each other and therefore they know each other's pricing structures. National Foods has traditionally been, for example, a processor who prefers not to have suppliers and to trade on the secondary milk market. They have found themselves in a situation because of the purchase they made of Dairy Farmers company. To get it over the line, they also had to look after Dairy Farmers shareholders, who were the farmers. Dairy Farmers worked very hard to make sure those shareholders were looked after, so National Foods found themselves in a situation where, realistically, they have a large amount of suppliers that they possibly would prefer not to have.

National Foods traditionally have been a major client of most of the major milk processors. Each of these processors obviously wants to protect their major client. So while I cannot table a document that quantitatively says this is happening, I know I personally have made approaches to be a National Foods direct supplier. I cannot get a phone call back. I have made approaches to Bega Cheese, I have made approaches to Parmalat and, without going any further, it is impossible. I cannot move, yet I am sitting 90 minutes from Sydney and we are the national Landcare primary producer of the year. One would think that people would want our milk. It is just impossible; I cannot move. I am told that if I move there will be no going back.

**Senator HURLEY—**This is an agreement amongst processors in a sense.

**Mrs Strong—**It would appear that way.

**Senator HEFFERNAN—**It is market power. This is the dumb ACCC.

**Senator HURLEY—**I am actually asking the witness.

**Dr Moss—**This is market segmentation. You look at Parmalat. Parmalat have started to strategically acquire clients for their Sydney base. At the moment, these have been very strategically acquired in the Hunter Valley and on the mid-north coast of New South Wales. You look from the outside and say, 'There are probably sane reasons for them to be going down that path' because that would then allow them to bring market to Sydney or freight it to southern Queensland in the event that they were short there. To my knowledge—and I am in touch with a fair swag of the production south of Sydney—there have been no approaches made, particularly in the Shoalhaven and Illawarra areas, by Parmalat directly to farms.

Similarly with Bega and National, they have been mutual clients of each other and they have milk-sharing arrangements that account for some overlap of clients. For logistic reasons some of the Bega supplies in the Gerringong area end up going to Sydney and some of the National milk produced in areas such as Bodalla, which is further south, will find its way down to Bega. From what I have seen in the past, there has been very little crossover of clients between those two suppliers. There has been some. But the experience I have had with my clients in the Illawarra is that it has been very difficult for them to progress too far down the line towards moving towards supplying Bega at this stage. That may change as Bega goes through some changes in coming years. It will remain to be seen.

There are also some smaller players such as South Coast Milk and those supplying Country Valley Milk at Camden. Again those markets are extremely small and have at this stage not been open to additional suppliers. So realistically the situation is, if you are in the Illawarra, you can supply National direct and they are the only people that have done that in the past, they have not opened their books to ex-DFMC members—

**Senator HURLEY**—The farmers supply National direct?

**Mrs Strong**—They get more per litre.

**Dr Moss**—They get different pricing structures.

**Mrs Strong**—Which is usually higher.

**Dr Moss**—A lot of this goes back to a split that occurred about the time of deregulation and there were some fairly solid divisions between people have wanted to go one way and people who went the other. A historical division evolved between those that supplied National and those that wanted to continue to supply the Dairy Farmers Co-operative. That division has remained and really has not been recrossed since then in many instances.

**Mrs Strong**—And the fact that dairy farmers are in the dispute resolution court and are very clearly saying that National Foods want to widen the gap between their direct suppliers and DFMC suppliers and this is contrary to the milk supply arrangement that was instigated when the two companies came together is a clear example that that is occurring and that DFMC suppliers are being disadvantaged.

**Dr Moss**—Over and above that, and I am not speaking of DFMC specifically, we have had a number of our clients who have been told, and this is right through the industry, ‘If you leave us you will not supply us again.’ One of the things deregulation was supposed to bring us was the ability to move freely amongst—

**Senator HEFFERNAN**—So that could be described as fairly predatory. Yet the ACCC in the little social wine group they involve themselves in cannot see that.

**Dr Moss—**You will never see any of this written down, but these are conversations that farmers have had with people up the chain, the companies. They are real conversations.

**Senator XENOPHON—**A supplementary question to Senator Hurley's. Can you going to more detail publicly about the sort of conversations you have heard?

**Dr Moss—**They have approached other processors to pick them up and some market has been agreed to. In doing that they have contacted their current processors and said, 'We are contemplating leaving,' and basically have been told, 'If that happens you will not be welcome back.'

**CHAIR—**Does that matter if you want a different processor?

**Dr Moss—**Absolutely, because it restricts the ability of that farm to say in a free trading environment, 'I want to go to where I can get my best price and I want to have the freedom and to do that provided they have capacity to take my supply,' which is an economic constraint, rather than a wall being put up to say, 'If you go don't bother coming back.'

**CHAIR—**Is that an empty threat? If all the farmers say, 'We will choose our processor according to price,' then maybe the game changes, the power is then with the farmers and the processors who want the milk have to offer more money.

**Senator HEFFERNAN—**It would be fair to say if that is the case if I am the processor who told you to go to hell if you change and I know that you are going off and there is only one other in the area and I occasionally have a glass of wine with him, he will know that he can screw you knowing that I have knocked you off. I mean, duh.

**Dr Moss—**You cannot go back.

**CHAIR—**Are there too few processors for there to be a free market?

**Senator HURLEY—**It is more that the processors are not competitive enough, that it is not a competitive market.

**Mrs Strong—**That is a fair assessment.

**Senator HEFFERNAN—**As plain as the nose on your face.

**Dr Moss—**That flows on to the supermarkets as well. 'If you take National milk and do not sell it at Coles, don't bother coming back.'

**Senator HEFFERNAN—**To take you to another arm of this: I am a milk vendor with 200 or 300 clients. I am contracted to a processor, one of the three majors. Obviously I negotiate a price. The local baker decides it is cheaper just to go down in the morning in the ute to get the milk from Coles. Does that not allow this behaviour to crib on market share by putting milk vendors out of business? Aren't they pinching more market share? As I understand it, they are now prepared to deliver to the bloke who used to take the ute down to Coles, to save him the trip to Coles. Is that something which you blokes have got your heads around?

**Mrs Strong—**Totally. It is a market share issue. It is all they want—

**Senator HEFFERNAN—**We had Treasury here this morning where you are now sitting. They just walked around in circles all morning with meaningless mumbo-jumbo—they looked like cadets. Why don't they get it? Yet you have a galoot here called Stephen King, who is a professor, who says, 'What are you complaining about? If Coles drops the price of milk, you'll sell more milk; therefore, dairy farmers can milk more cows.' How illogical is this dead head?

**Mrs Strong—**A lot of the time we are forgetting that private label milk is sold into Coles and Woolworths at a very low price with the only aim being getting the branded product on the shelf and getting their product on the shelf. That is the only way they can do it. It has been that way traditionally. It is the requirement. 'You have to sell us the private label at rock bottom.' That is why this tender process is raised to the bottom. They need it to be that low so that they can create the differentiation. The more you draw profit away from the brand and give it to the private label the more you are destroying the processors' ability to share profits with the farmers.

**Senator HEFFERNAN—**Surely this is all about Coles retrieving market share from Woolworths—they both have too much market share. Do you think we should all go to the farewell party to Mr McLeod when he gets his $38 million and goes back to live in his castle in Scotland? That is what it is all about. It is market share, repositioning Coles in the market in case Tesco or someone else wants to buy it. I mean, God help us!

**Mrs Strong—**With the committee's permission, I can tender some documents which expand on that particular issue within the milk supply arrangements between processors. It clearly states that what was promised in deregulation has not been delivered. Farmers are virtually stuck where they first put their hats in the ring.

**Senator HEFFERNAN—**I would be happy to see them tabled.

**CHAIR—**Yes.

**Senator HEFFERNAN—**Don't forget, if anyone intimidates you, let us know.

**Senator XENOPHON—**Dr Moss, you consult more broadly or you give advice on dairying overseas as well—is that correct?

**Dr Moss—**My business partner does. I have very little work overseas myself.

**Senator XENOPHON—**How do we compare with other countries? It seems from the limited information we have that New Zealand dairy farmers are in relatively much better shape than we are. What impact does that have on the market, on consumers and on the industry generally? Concerning the argument by Professor King and by Coles that this will not affect the chain, your evidence is that the industry is already working on very tight margins as it is.

**Dr Moss—**That is correct.

**Senator HEFFERNAN—**Do you think it is possible that Fonterra, with the rebate to their dairy farmers in New Zealand, are gaining a bit of that out of Australia?

**Dr Moss**—It is a listed company that generates profits from Australian business, so some of that must go back to their shareholders.

**Senator HEFFERNAN**—And the rebate to the New Zealand farmers, who own the joint.

**Dr Moss**—The world is full of fundamentally different dairy industries. If you look at Canada, for example, you have got an industry there where milk prices are extremely high but extremely regulated. You have a very strong quota system that still exists over there. Farmers have to buy the right to supply milk and those quotas are extraordinarily expensive.

**Senator XENOPHON**—Milk is much more expensive there?

**Dr Moss**—Absolutely. Lynne has had family spend time in Canada and there are a number of 40-, 60- or 80-cow farms over there that are completely viable. It is a very different situation to that in Australia. We just cannot function like that. If you look at New Zealand, the market is completely different as well.

**CHAIR**—Would you give us some details on New Zealand because we are interested in that comparison.

**Dr Moss**—It is a large market that is predominantly manufacturing in orientation. I would estimate that 90 per cent of their milk is not consumed in New Zealand; it is exported. Because of the climate in New Zealand—it is a very Mediterranean style climate in that country characterised strongly by winter rainfall and spring rainfall—their production is extremely seasonal and highly linked to grass. At the moment they are definitely beneficiaries of a world export market. The flip side to that is that when world prices have been poor, such as during the global financial crisis, the New Zealand market was quite exposed and there was significant trouble within that market, as there was in the southern parts of our own manufacturing market. During that time, a number of our year-round suppliers were engaged in contracts that had been written well in advance. They were actually performing quite well in New South Wales and southern Queensland because they had decent long-term contract arrangements at that time that provided sustainable milk prices for those businesses to function and perform well. If we look at the South American market, which is a developing market, it has got quite a strong local base of consumption but it also has an evolving export base. We can supply, if required, on notice some more details on those markets to the committee.

**CHAIR**—We would actually appreciate that because we want to be able to make comparisons. The Canadian story is very interesting. The New Zealand story is interesting.

**Senator XENOPHON**—Finally, the argument of Professor King and perhaps of Coles as well is: ‘There is a strong export market. What are you worried about? Fresh milk is only a small part of it.’ The argument of Mr Brokenshire, a South Australian member of parliament and a dairy farmer, was that you need that fresh milk market to underpin your other activities. Who is right on that?

**Dr Moss**—There are two markets in Australia. It is almost like comparing wool and beef. We have got the southern market, which is our commodity market, that is performing will at the moment. Luckily that is allowing a very high cow value at the moment, which is actually underpinning some of the financial difficulties in northern Australia because of the sale of cattle and good prices for cows. If you look at what is happening in New South Wales and Queensland, over the last five years we have had a progressive dismantling of our secondary processing capacity. Milk surplus to drinking milk requirements could previously be processed within those states predominantly at plants in Hexham and in southern Queensland. As that has been progressively removed, our year-round milk-producing businesses, which are completely separate to the Victorian business, are now faced with a situation where, if they produce milk over and above the drinking requirements in those markets they are in, they are exposed to the price of milk in Victoria less the cost of freight, as opposed to what Senator Ryan was referring to before where we were actually given prices that were the cost of milk produced in Victoria plus the cost of freight. We have effectively moved back to quota systems being regulated through our tier 1 and tier 2 milk systems. If we are producing above tier 1 milk in spring in particular, previously we would have been working our business on getting 45c, 50c or 55c for that milk depending on where you are, but it is now effectively being dumped back into Victoria at prices just below 20c.

**Mrs Strong—**And then you are assuming that those processors, whose manufacturing plants are tailored to supplying the export market, would then decide that they wanted to play games with Coles and Woolworths. If you were getting much more money for your export milk, why would you then want to come back into an anticompetitive market and play games in Australia; move up to Sydney, obviously, where the consumer is; and set up liquid milk processing plants? I certainly would not move into that market if I were Murray Goulburn. This is the issue. We are assuming, 'All right; all the fresh milk producers fall over. Okay; we will just get our milk from Victoria.' But that would depend on those major processors and whether they want to get involved in a market that is sending those fresh milk market producers broke. I certainly would not. I do not think you can assume that that would happen. I think that would be a very dangerous road to travel.

**CHAIR—**Where do you see the dairy industry in 10 years time?

**Mrs Strong—**I believe that the Australian dairy industry has a great deal to offer, both export wise and domestically. The health, wealth and happiness of Australians depend on it. Australian consumers should be able to have fresh, affordable, nutritious milk supplied directly from farmers like ours who are only 90 minutes from Sydney. You could not ask for a more perfect place to dairy. And farmers in our region have shown that they can actually cope with the fact that over 80 per cent of the prime agricultural land is owned by rural lifestylers. We can adapt. We can supply that fresh food market. We should be able to do that, because we do a great job at it. But to do that we have to operate in a fair market.

**Senator HEFFERNAN—**So just coming to terms with what has happened in Australia—which seems to be what Tesco, Sainsbury's and others have just done in the UK. These guys have come out here to teach Australia how to do what has happened and be paid a substantial amount more money in Australia than they got back there in England. Part of the commotion that caused, the inquiry found, was that major supermarket chains were passing on excessive risks and unexpected costs to their suppliers. You could take this on notice if you like: could you provide any evidence of that here, given that the Tesco model is what is being tried in Australia under the cover of increasing export prices? Everyone says, 'It's A-OK, brother; the cows won't go to the saleyards.' The bill that they have proposed will pay a minimum price. But one of the problems they came across in England was that the suppliers copped the added costs of advertising, which are not in the contracts, and all the add-on bits were passed back to the suppliers. Do you have evidence of that here—that you get unexpected costs? Anyhow, take it on notice. And could I refer you to page 37 of today's briefing pack.

**CHAIR—**I am sorry but we are well over time, we have another witness and we are going to lose our quorum in 20 minutes.

**Mrs Strong—**Thank you so much for giving us this opportunity.

**Dr Moss—**Thank you.

**CHAIR—**Thank you very much indeed for your evidence.

[2.39 pm]

**GRATION, Ms Julie Maree, Owner, Flatout Programming and Consultancy Pty Ltd T/A Macarthur Milk**

**WHITE, Mr David, Authorised Representative, Flatout Programming and Consultancy Pty Ltd**

**CHAIR**—Welcome. I invite you to make a short opening statement.

**Ms Gration**—Thank you for the opportunity to appear today regarding the dairy industry and the impact of the pricing war Coles and Woolworths are having. We own a Dairy Farmers franchise and have done so for six years. We deliver to small businesses in the Macarthur region. We operate a multitrack run, which has been up for sale for two years in June. We are far from industry experts and the reason we lodged our original submission was to try to shed some light on the pricing aspect of our side of the industry: the supply of milk from the processor via my company to the retail outlets.

Eighteen months ago I lodged a Senate submission regarding the dairy industry. The only change from then to now is that it is a whole lot worse for us. Coles and their $2 two litres have seen my customers—coffee shops and general customers who use milk for cooking or coffee—leave altogether and go to Coles and have their milk delivered for $2 in a refrigerated truck. These were loyal customers. They were loyal to my business prior to this $2 milk thing started but, when they do the maths, they see that they can get their milk delivered to their door for less than I can offer. The hardest thing to fathom is that I am a franchisee of the same company that is producing and selling milk to Coles for less than $2 a litre and my customers do not understand how this can be happening.

In the six years that I have owned my business I have had to increase the prices to some of my customers no fewer than six times on various products. To add insult to injury, they send me copies of receipts from their local service stations where my customers can by a three-litre milk that I deliver to a different outlet cheaper than I can sell it to them. They argue: ‘But you deliver it on your truck,’ and ‘Look forward to selling more milk to that service station because I am going to buy my milk directly off them; it is cheaper than you.’ Why? It is because the service station is part of a group, and my franchisor, Dairy Farmers Ltd, a division of National Foods, negotiate with that group and ask me to sell them milk below my cost. They reimburse me the cost of the milk, which is $2.77 a bottle, and then, depending on the group, I get between 11c and 15c per litre profit. With generic milks, of which there are a few different brands nowadays, I make 6c a litre on some.

I will give you an example of the disparity. I have a retailer who is part of a buying group. He buys a two-litre generic milk from me for $2.01 and a branded whole milk for $2.10. This retailer sells his generic milk for $2.55—a profit of 54c—yet he sells his two-litre branded milk for $3.50, a profit of $1.40. For this milk I get paid 11c per litre for the generic and 23c per litre for the branded. He sells a wide range of grocery goods in his store. I sell only milk, juice and dairy. I am limited to who I can obtain product from, because I have a franchise agreement that states that I must get my product from National Foods. There are very rarely customers paying wholesale shop price for milk—for white milk, in particular—and, depending on the customer and the pricing offered and whether they are part of a recognised buying group, we are sometimes paid less profit than the numbers I mentioned previously.

I raised concerns that we had regarding collusion to the ACCC. As franchise owners we are all independent businesses in the eyes of National Foods; however, we are forced to sell milk to certain groups, conglomerates, at a certain price. The ACCC's response to me was, 'Be careful, because it is not the franchisor breaking the law; it is you.' On the flipside of that, under my franchise agreement I must sell to their negotiated customers at that price or they remove the customer.

So who is at fault? According to the ACCC, they are not the franchising police—'Get legal advice.' Perhaps the ACCC and others are under the impression that milkmen make a fortune. Prior to deregulation, perhaps; but, in the current environment, I can tell you that it is not as profitable as it was in the past. Making ends meet with lease payments, a business loan, workers comp, wages et cetera, there is little left at the end of the line. In particular, when you know a delivery day is not feasible and you cut it out, it does not help when your franchisor forces you to put deliveries on that day. This has happened to me and I am now paid a support payment. However, the delivery fees, along with the support payment, do not cover the daily cost to run my business on that day. On average, I am delivering to five customers on that day. So much for my independent business!

According to the National Foods submission to this inquiry, I am part of the backbone of its chilled distribution system delivering branded products. My question to National Foods is: if branded milk is your backbone, why do you sell branded product in some cases at prices comparable to generic milk? Why do you offer ridiculous pricing to customers, regardless of their volume, on branded products? I have always, in my business, tried to sell the branded product rather than the generic, and I have actually been reprimanded by the franchisor for not supplying generic milk to a customer whom they cannot force me to sell generic milk to. However, the deals that are made by the processor and certain groups has seen my area slowly become more dominated by generic milk. I have to supply generic milk and get paid a pittance to deliver to their group-buying customers. I understand it is good for the consumer. Being a milko, I actually buy my milk at Coles—generic home brand—because it is cheaper than I can buy it directly off the processor.

Our prices have only increased in the past six years. Our franchisor, the processor, has only reduced the commission and the rebates we are paid to deliver the milk. They extended our credit terms from seven to 10 days, yet the customers whom the bill directly, who buy less milk than me and are often charged less for their milk, are extended credit terms of 14 days from end of month.

I have in the past tried in vain tried to negotiate better terms, product range, pricing and supply. The standard response is, 'We'll look into it.' Generally a couple of months later they implement a price rise. It is like banging your head against a brick wall. Like the farmers, we tried to get a group of franchisees together to negotiate with National Foods, only to be ridiculed by the vendors association and ostracised by the franchisor.

For two years I have endured endless heartache from my franchisor. Why? Because I chose to stand up, ask questions and tell the truth. I have been victimised and discriminated against and forced to do things no other franchisee has. Management have sent me numerous messages by intermediaries, all after my previous submission was published, that they would see to it that I end up with nothing. My family has suffered enough heartache. I personally had a nervous breakdown at this time last year, caused by the big multinational determined to screw over the troublemaker and the small business owner. The way I figure it is: if I am going out with nothing, I may as well come here, have my say, stand up and try to create a fairer playing field for all concerned in the industry. I am speaking from a franchisee’s perspective. I do not have all the answers, but I know there has to be a fairer system than the one we currently operate under. With Coles and Woolies and their $2 two-litre milk, the financial investment I made in my business will be worth nothing anyway.

**CHAIR**—Thank you, Julie, for coming here. We appreciate your frankness and your courage in presenting that information to us.

**Senator HEFFERNAN**—Could I just ask about the consequences of appearing at an earlier Senate inquiry—

**Ms Gration**—We did not appear.

**Senator HEFFERNAN**—Did you make a submission?

**Ms Gration**—Yes.

**Senator HEFFERNAN**—Do you think, as a consequence of that submission, you were in any way intimidated?

**Mr White**—There was a phone call that we got from the AMVA. You heard from them yesterday. We received a letter from National Foods in November 2009 after our submission was published in, I think, August. Our franchise agreement was due to be renewed in August. We kept asking them to renew it and they kept ignoring us. Our submission went in, we received a letter in November saying, ‘You have until the end of March to sell your run or you are out the door with nothing.’ We then got a phone call from the AMVA saying that Gary McMahon from National Foods rang him and told us to call off our dogs. We had spoken to Alan Jones and I think we had spoken to you about it as well. That is the response we got from National Foods.

**CHAIR**—Did they at any time suggest that this behaviour was related to your appearance before a Senate committee?

**Mr White**—It was just very coincidental that after we put in the submission—

**Ms Gration**—And also, because we did get a group of vendors together in the March prior to the October when the submission was put in, they will now say that it was because of the group of vendors that we got together. You will never prove it.

**CHAIR**—But it does sound as though, very probably, this all followed from your providing evidence to a Senate committee, which is—

**Ms Gration**—When they are offering potential purchasers—other vendors where we pull out of—financial incentive to buy my run to 'get rid of me' and I have their sales teams going out and telling my customers, 'Don't worry; it won't be long,' you would assume that they are quite keen to see me out of the system because they know that I have spoken the truth and they do not want the truth out there.

**CHAIR**—As we said earlier, intimidation of witnesses to Senate committees is illegal. If you can come up with any link to your evidence we would be very interested in hearing about it.

**Mr White**—It will be very interesting to see what happens tomorrow—if our milk is at the depot.

**Senator HEFFERNAN**—Can I take you to what are described as rebate discrepancies. Thank you very much for the list of people that you supply and the fact that you buy it at $2.77 and then have to supply it down—

**CHAIR**—With great respect, Senator Hurley has a question for the witnesses, so why don't we let her ask it.

**Senator HEFFERNAN**—No worries.

**Senator HURLEY**—In evidence to this inquiry we have heard from the dairy farmers that they are not making any money, from the milk processors that they are not making any money, from the vendors that they are not making any money and Coles supermarkets assure us that they are not making any money. It is very difficult to know what is going on.

**Ms Gration**—I did not say we do not make any money. What I am saying is that on white milk we make predominately less; on flavoured milk we made predominately more. Because we buy milk at $2.77 regardless of whether it is generic or branded, depending on what the sell price is we have three different types of customers. We have rebate customers, where they go out and negotiate a group pricing structure—for example, there would be a Michel's or a McDonald's—which is below our cost. What happens is we will charge the contracted price that National Foods have negotiated. They will top us back up to that $2.77, which is our cost, and then they will pay us depending on the customer between the 8c and 11c a litre.

**Senator HURLEY**—We have heard some suggestion that Coles might be starting to get into the business of distributing the milk themselves. Do you think that is likely to happen?

**Mr White**—At the depot that I pull out of, at Campbelltown, there is a vendor who lost 15 customers last week to Coles home delivery for $2 milk.

**Senator HURLEY**—So that is already starting to have an impact on the distribution of milk?

**Mr White**—Yes. The coffee shops that are in the supermarket complexes that have Coles, Woolworths or Franklins are just walking up—

**Senator HURLEY**—To go and buy it themselves.

**Mr White—**That is right. They wheel it back on a trolley. A lot of the time you can walk into Coles and speak to the manager and you will probably be able to get an account.

**Senator HURLEY—**The other thing is that this is something that is good for the consumer. They are getting cheaper milk.

**Mr White—**It is fine for the consumer. Like Julie said, we buy our milk from Coles or Woolworths. Why would we spend $2.78 to get if from our franchisor when we can get if for $2?

**Senator HURLEY—**Your problem is that this will feed down through to the industry. Let's be blunt about that. If Coles distribute their milk and you go out of business, it does not matter to the consumer, does it?

**Mr White—**No, they still get their milk but it will not be at the corner shop.

**Ms Gration—**We do not have access to the same amount of generic milk and the same pricing for that generic milk to go and compete against Coles. Our customers, of which I have 90, and their frustrations... The lady in the bakery who goes and buys her three-litre containers of milk at the Caltex down the road because I have to sell it to him at a contracted price. She is one of my general wholesale customers and, in our trade, they are the ones we have to keep happy by packing their fridges and all those sorts of things, because she is paying top dollar for her milk compared to the Caltex down the road.

**Mr White—**You were wondering who makes money in the whole supply chain. May I table a list of the major products that we sell? We had a price rise on 25 February 2007. Our last price increase was on 7 June 2009. For the central region DFMC pricing the farmers had a 16c increase at the gate. I do not know what it would be now, because this was roughly two years ago. On some products our increase was 58c, 32c, 50c, 90c and 85c per litre. So, if the farmer is only getting 16c and we are copping a price increase per litre of up to 90c, you can make up your own mind about who is making the money.

**Senator HURLEY—**It would be very good if you could table that.

**CHAIR—**Is the committee happy to accept this as a tabled document? There being no objection it is so ordered

**Ms Gration—**I heard the waterbed effect mentioned a lot in these inquiries. Yes, that happens to a degree, but you will find that those in the route trade business, which is what we are in, do not have a contracted price that we pay for their milk with National Foods. They are entitled to put in a price increase whenever they like, which they do. You will find that we are the ones who push and subsidise—franchise owner held accounts held by us are the ones who subsidise the cheap milk for everybody else.

**Senator HURLEY—**If you were to make a measure to fix the market, would it be freeing up competition at processing?

**Mr White**—We are bound by a franchise agreement. We cannot walk down to Coles, IGA or Woolworths if, for argument's sake, Dairy Farmers milk is on special and grab a palette and stick it on the back of our truck. We would make a fortune if we could, but we cannot.

**CHAIR**—Would Coles sell it to you if you asked them?

**Mr White**—Yes, but we cannot. If we got found out, we would lose our business.

**Ms Gration**—It is a direct breach of the franchise agreement.

**Senator HEFFERNAN**—Doesn't that say that you are expendable?

**Mr White**—At the moment we are probably not expendable because we are worth too much cash flow to National Foods.

**Senator HEFFERNAN**—But at the end of the day because of market power—82 per cent of the package market is in Woolies and Coles—they can negotiate a bigger ambush of the processors for a price reduction or a competitive edge—

**Mr White**—The only people screwing the dairy market at the moment are the four big processors we have in Australia. You have National Foods, which I read in a submission has 80 per cent of the processing capacity in Australia; Parmalat; Fonterra; and Murray Goulburn. I will give you an example. We use to supply milk to McDonald's. Parmalat came in and said, 'We will give you a month's worth of free milk just to get your business.' That is just stupid.

**Senator HEFFERNAN**—They said that to McDonald's?

**Mr White**—Yes. To get McDonald's business in the Macarthur region where we come from—

**Senator HEFFERNAN**—Wouldn't that be described in the best of legal terms, when you put all the colourful words and garbage around it, as predatory to put you out of business?

**Mr White**—Probably. We have PROCAL at the moment at Campbelltown, which is Murray Goulburn, running around selling two-litre branded milk at $2.15 and two litre modified milk like Lite White or Skim at $2.15. Our sales managers who are supposed to go out and get us business have been told not to go near that price—'Forget it. We will not go down to it, so you will just lose that customer.' Once our price goes below $2.90 we have to go back to the franchisor and then they have to go in and say they will sell it.

We are in exactly the same boat as the farmer. In the supply chain the farmer's profit is determined by the processor because the processor determines what gate price he gets and the franchisor determines our profit margin because 90 per cent of the customers we deliver to contract the price and they determine what rebate we get paid.

**Senator HEFFERNAN**—In the rebate system, one outlet that you supply gets a bigger rebate, so you get that back I presume—

**Mr White**—I do not know how the rebates—

**Senator HEFFERNAN**—How the hell do they work out they will give that bloke a 35c reduction and this one 15c?

**Mr White**—Who knows? How the rebate system works is: if we buy it for $2.77and if we sell it to someone for $2, we might get 30c rebate. Effectively, all National Foods is getting for that two-litre bottle of milk is $1.70, because once they pay us back the money, plus the 30c rebate on the bottle of milk, all National Foods is making on that branded bottle of milk is $1.70.

**Senator HEFFERNAN**—Is that the one you have got today or is that a separate one?

**Mr White**—No—that is the one I have—

**Senator HEFFERNAN**—I have not distributed that.

**CHAIR**—National Food did make the point that their profit margins were very small.

**Mr White**—I would like to ask them whether the two per cent is on the grocery side of it or outside of it. If you have a look at what they call the non-retail chain, or the non-grocery chain, which is us—outside of it—they are making more than two per cent.

**Senator HURLEY**—No. I asked them and they said up to five per cent on the non-white milk.

**Mr White**—I would like to know if that is in grocery—

**Ms Gration**—I have a letter here from National Foods that is addressed to the franchise owners stating:

For the record, National Foods profit margin on white milk, branded and private label combined, is less than two per cent.

That was addressed to a franchise owner, so I would assume that is across the board.

**Senator XENOPHON**—I think it has been covered pretty well. It is obvious you are not encouraged to speak, and I think you are at the end of your tether in terms of what has happened. How many other milk vendors are in a similar position to you but feel that they cannot speak out?

**Mr White**—Three hundred.

**Ms Gration**—Put it this way: we—David, me, Stephen and a few others—got 100 vendors together and we lodged a dispute with National. They met with us. We sat at a table. We had a committee of franchise owners. There was someone from each depot, so everyone was well represented. They virtually laughed at us, as did the AMVA. We were told to go away, basically, that they would look into things and they never got back to us.

**Senator XENOPHON**—How long ago was that?

**Ms Gration**—Nearly two years ago, in April. We then went to see the Office of the Mediation Adviser, because under the franchising code we are allowed to go there. We went there and asked if we could approach as a committee rather than 100 of us. National Foods wrote back to the Office of the Mediation Adviser and said ‘We won’t deal with you collectively. We want to deal with you individually at a cost of $1,200 per franchise owner.’

**Mr White**—That is pretty much what they do to farmers at the moment, where they would rather deal with one farmer at a time instead of the DFMC.

**Ms Gration**—They actually did that with our dispute group. People were pulled aside—

**Mr White**—People were paid off. They were given milk runs, which are now going broke and the vendor’s want to sell them, and National Foods turned round to them and said, ‘They’re not yours. You can’t sell them. They’re ours.’

**Senator XENOPHON**—You will let us know if there are any changes in your relationship with National Foods—

**Ms Gration**—It will only go backwards.

**Mr White**—It will get worse. One of the other reasons that processors are trying to wipe each other out is that they make milk for each other. When Parmalat bought FreshCo, which was the divested part in the merge, National Foods sold the Lidcombe processing plant to Parmalat, which was the biggest processing plant in Australia for fresh milk. National Foods have a processing plant in Penrith. The Penrith site, which is owned by National Foods, makes milk for Parmalat. So National Foods know exactly how much the bottled milk costs, because they sell it to Parmalat. National Foods get milk bottled at Lidcombe, which is owned by Parmalat, and Parmalat invoice National Foods for the milk.

**Ms Gration**—You can tell on the bottle. It will have a two-code—

**Mr White**—You can look at the use-by codes on the bottle. If it has a PE on it, it was made in Penrith, and if has a BH it is made in Baulkham Hills, and if it has no letters it is made at Lidcombe.

**Senator HEFFERNAN**—The ACCC does not think that is collusion?

**Mr White**—Probably not. That is all sweet.

**Senator HEFFERNAN**—Is there anything else that you are busting to tell us?

**CHAIR**—May I say, in relation to that, you must understand this is a very special forum. Because you are appearing before a parliamentary committee you are covered by parliamentary privilege and no legal action can be taken against you for anything you say in this forum. The moment this committee’s proceedings end then you are liable for any comment you may make.

If you really do want to say something and be covered by parliamentary privilege this is the forum to do it in, but consider it carefully.

**Ms Gration**—I am at the end of my tether. I would rather not be a National Foods franchise owner. They know that and I know that. They are not prepared to initiate their clause under my franchise agreement to pay market value for my run. Instead they are prepared to go behind the scenes and top-up interested parties to more profitable margins to buy my run. I have been told to take what I can get, basically, by the vendors association. I just want to leave the system knowing that there is some fairness for the farmers, because the area that we are predominantly in, the Macarthur region, is full of farmers. The guy on the Dairy Farmers bottle is down the road from us. I just want to know that I have, somewhat, made a difference.

**Senator HEFFERNAN**—Is the vendors association not on side? Aren't you one of them?

**Ms Gration**—The vendors association, AMVA—

**Mr White**—They came in yesterday and all they talked about was farmers. Without farmers you do not get milk, obviously, but they are the vendors association and they should have come in—

**Senator HEFFERNAN**—Why don't they stick up for you? Are they sort of drinking in the same club or something as the processors?

**Ms Gration**—They talk to Parmalat and they talk to National Foods. Does that tell you something?

**Mr White**—They talk to Murray Goulburn and they talk to Fonterra. They go and talk to all the processors.

**Senator HEFFERNAN**—It is like the industrial relations club. Just to refresh my memory, Parmalat and National Foods cooperate at a factory level to manufacture—

**Mr White**—They invoice each other for their milk.

**Senator HEFFERNAN**—Whose milk does Parmalat manufacture for National Foods in the Parmalat factory? Is it National Foods milk when it goes into the Parmalat factory or is it Parmalat's milk that they process and have some sort of cosy arrangement? Who owns the milk?

**Ms Gration**—The ACCC undertakings.

**Mr White**—In the undertakings that National Foods gave the ACCC when they bought Dairy Farmers they had to supply Parmalat with a certain amount of raw milk. The amount of raw milk that National Foods were to supply they would be flat out supplying for a week. I would assume Parmalat are buying their milk from National Foods, the raw milk, after National Foods buy the raw milk off either the DFMC or any individual farmer that they have contracts with. The tankers would not go to Penrith and then to Lidcombe; they would go directly into Lidcombe.

**Senator HEFFERNAN**—Isn't it collusion?

**Mr White**—Probably, but I am not a lawyer.

**Senator HEFFERNAN**—Well, I am a worn out wool classer and a welder.

**Mr White**—I am a welder too. Like I said, when we had the dispute with the ACCC, when we put in the dispute with National Foods, we threw the kitchen sink at them. We accused them of price fixing, maintenance, unconscionable conduct, the works. That is why they do not like me.

**Senator HEFFERNAN**—As a consequence, by hook or by crook and by coded message, you got a message saying, 'You've had it, son.'

**Mr White**—Yes. The reason I threw price fixing at them was because of the list you have in front of you. They fixed that price in our system because it is locked. On our ordering system it is a locked one; we cannot change that price. They maintain that by putting that price into system and they control that price and they negotiate that price and we have no—

**Senator HEFFERNAN**—This list is going to enable more market power to go to Coles, or Woolies or someone, Coles in this case, because of this arrangement here and because they do not like you and, you say, another 200 or 300 other people that have been offended.

**Mr White**—They like the majority of them because they keep their mouth shut.

**Senator HEFFERNAN**—Yes, but these other blokes have the same problem that you have.

**Mr White**—That is exactly the same pricing that every other vendor in New South Wales gets.

**Senator HEFFERNAN**—But they keep their mouths shut. This enables Coles eventually to get a bigger share of the market because they will supply these people here direct if they are big enough.

**Mr White**—I do not know how Coles would go with the corner shop selling.

**Senator HEFFERNAN**—The corner shop will just go down to Coles, if there is a local Coles, and bring it back.

**Ms Gration**—I do not know the laws on resale of generic milk. I know some of my shops have tried and put it in my fridge back when I was paying for it. I said, 'No, you're not putting that in there. Get it out.' Generally it is not so much resale; it is more the coffee shops, the restaurants and people like that.

**Senator HEFFERNAN**—Yes, the processors.

**CHAIR**—We are going to have to cut it short there. Bear in mind what we told you about parliamentary privilege. It only applies while you appear before a parliamentary committee. I thank the witnesses for appearing today.

**Committee adjourned at 3.10 pm**