

# Chapter 1

## Introduction

1.1 On 14 September 2016, the Senate referred an inquiry into the Australian dairy industry to the Senate Economics References Committee for report by 24 February 2017, in order to establish a fair, long term solution to Australia's dairy crisis, with particular reference to fresh milk security and:

- the legality of retrospective elements of milk contracts;
- the behaviour of Murray Goulburn; and
- any other related matters.

1.2 The reporting date for the inquiry was extended on a number of occasions—initially to 30 March 2017 on 13 February 2017, to 11 May 2017 on 27 March 2017, to 29 June 2017 on 10 May 2017, to 10 August 2017 on 20 June 2017, and finally to 17 August 2017 on 9 August 2017.

1.3 The referral of this matter was part of a general business notice of motion where the Senate noted that:

- (a) the Australian dairy industry is facing an unprecedented crisis with the retail cost of bottled milk per litre often less than the retail cost of bottled water;
- (b) Australian milk production since deregulation over 15 years has decreased from approximately 11 billion litres per year to 9 billion litres per year – a 20 per cent decrease, while New Zealand milk production has almost doubled;
- (c) in 2011, a report of the Senate Economics References Committee recommended that producers' contracts with dairy farmers should offer a clear, consistent formula for milk pricing with unambiguous conditions;
- (d) five years later, the livelihoods of up to 40 per cent of Australian dairy farmers are under threat because of imposed, retrospective debt, helped by unclear, inconsistent milk pricing contracts with ambiguous conditions;
- (e) Australia's largest dairy producer and milk price setter, Murray Goulburn, has been allowed to force onto its suppliers unprecedented milk contracts or agreements ensuring that dairy farmers are burdened with retrospective debts ranging from tens to hundreds of thousands of dollars;
- (f) Australian rural and regional communities face losing millions of dollars and thousands of jobs if a fair, long term solution to Australia's dairy crisis is not found; and

- (g) the mental and physical health of dairy families and workers are being unnecessarily and unfairly placed in jeopardy as politicians, legal and industry experts argue about possible solutions to the dairy crisis.<sup>1</sup>

### **Conduct of the inquiry**

1.4 The committee advertised the inquiry on its website and wrote to relevant stakeholders and other interested parties to draw attention to the inquiry and invite them to make written submissions.

1.5 The committee received 46 submissions as well as additional information and answers to questions taken on notice. They are listed at Appendix 1.

1.6 The committee held six public hearings:

- 26 October 2016 in Canberra;
- 15 November 2016 in Melbourne;
- 31 January 2017 in Brisbane;
- 1 February 2017 in Perth;
- 2 February 2017 in Shepparton; and
- 3 February 2017 in Burnie.

1.7 A list of witnesses who appeared is at Appendix 2.

1.8 References to Committee Hansard are to the Proof Hansard and page numbers may vary between the Proof and Official Hansard transcripts.

1.9 The committee thanks all of the individuals and organisations that assisted with the inquiry, especially those who made written submissions and/or gave evidence at the public hearings.

### **Background to the inquiry**

1.10 Since deregulation in 1999, the Australian dairy industry has undergone a series of structural changes, resulting in a significant consolidation of dairy farm enterprises and widespread privatisation of processors. At the same time, retail competition in the dairy product sector has intensified with the aggressive promotion of 'private label' or 'homebrand' products—exemplified by the availability of \$1 per litre milk since 2011. While there is no argument that low retail prices have been beneficial to consumers' purchasing power, a significant amount of value has been removed from the dairy value chain which has affected the viability of dairy farmers and processors.

1.11 Despite being Australia's third largest agricultural industry, many dairy farmers are finding it increasingly difficult to cover costs and continue in the industry. Over the last decade, the farm gate milk price has been relatively stable while the cost of production has increased significantly.

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1 *Journals of the Senate*, No. 6, 14 September 2016, pp. 195-196.

1.12 Responding to low domestic prices and seeking better returns, some processors, particularly cooperatives, made strategic decisions to become more export orientated. However, international market conditions have deteriorated since 2014 following a Russian trade embargo and relaxation of production quotas in Europe. This oversupply drove world dairy commodity prices down and increased competition for the remaining markets in Asia and the Middle East.

1.13 As a result of these challenging market conditions and a range of poor domestic management decisions, the dairy industry reached a crisis point in April 2016. At the time, Australia's largest dairy processor, Murray Goulburn Co-operative, reduced the farm gate price paid to its dairy suppliers in southern regions of the country—Victoria, South Australia and Tasmania—retrospectively for the entire 2015–16 season. Fonterra Australia, the second largest processor in Australia, followed suit in May 2016. This retrospective 'step down' in farm gate milk prices by the two largest processors forced affected dairy farmers to accept a price reduction of more than 10 per cent in their milk prices for the entire year—a pricing 'clawback' that effectively meant many farmers in these regions were paid very low prices for the milk they produced in the final two months of the season and potentially incurred a substantial debt either to the processor or privately.

1.14 Although cyclical price fluctuations are not unusual for export-exposed agricultural industries, the international dairy price downturn was exacerbated by the retrospective price reduction late in the 2015–16 season by Murray Goulburn. Many farmers were ill-prepared to absorb the low farm gate milk price over the remaining two months, particularly if they had already made investment decisions based on reasonable expectations about the farm gate milk price. This confluence of international and domestic events helped to create a 'perfect storm' which crippled many dairy farmers in the southern regions where the majority of Australia's milk output is produced and manufactured dairy products are processed.

1.15 While some processors and dairy farmers in other regions were not directly affected by the actions of Murray Goulburn and Fonterra, these events highlighted the crisis facing the dairy industry in Australia and prompted the Senate to initiate this inquiry.

### ***Previous inquiries into the Australian dairy industry***

1.16 The committee notes that there have been two significant inquiries undertaken into the dairy industry in Australia by the Senate Economics References Committee in the last eight years:

- *Milking it for all it's worth—competition and pricing in the Australian dairy industry* reported in May 2010 (the competition and pricing inquiry); and
- *The impacts of supermarket price decisions on the dairy industry* reported in May and November 2011 (the supermarket impact inquiry).

1.17 The competition and pricing inquiry succinctly explained the transition of the industry since deregulation and the events that led to the referral of that inquiry in September 2009:

Since its deregulation in 1999 the Australian dairy industry has evolved from a protected and regulated industry with many small farms, to one based on few but larger farms competing both nationally and internationally. During this period, significant consolidation has also been occurring at the retail and processor levels, which are now dominated by two supermarket chains and a handful of (now mostly foreign owned) processors, placing the farmers at a competitive disadvantage. These structural changes were masked in the boom years. Indeed in 2007–08 Australia's dairy farmers were receiving record high farmgate prices for their milk and confidence was high—there was overconfidence in some industry advocates. That changed more or less overnight with a fall in the international commodity price which was followed by processors announcing price step-downs.<sup>2</sup>

1.18 The conditions described above were essentially mirrored by the circumstances leading to the 2015–16 crisis:

- confidence was high following the high milk prices in 2013–14 and 2014–15, and farmers were being encouraged to increase herd size; and
- international prices collapsed following supply gluts and demand reductions.

1.19 Arguably, the biggest difference between the events of 2007–08 and 2015–16 was the size and timing of the step-down, and the impact that this had on farmers who were assured by Murray Goulburn up until the step-down that the forecast prices for 2015–16 would be met.

1.20 The supermarket impact inquiry was referred following the heavy discounting of private label milk and dairy products (including the introduction of \$1 per litre milk) by Coles and its competitors from January 2011. While accepting that lower prices provided a positive outcome for consumers, concerns were raised regarding the effect of price cuts on the dairy farmer's incomes and the ability of some milk production regions to meet future demand for drinking milk.

1.21 The work of these previous inquiries outlined some of the challenges facing dairy farmers then that, in one form or another, still persist:

- power imbalances exist across the industry that result from larger players being able to dictate terms to the weaker parties (for example, retailers on processors and processors on farmers)—including collective bargaining arrangements and low-cost avenues for dispute resolution;
- lack of a clear, consistent formula for milk pricing with unambiguous conditions;
- reductions in the number of farmer-owned cooperatives and the benefits that accrue to farmers from the cooperative model;

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2 Senate Economics References Committee, *Milking it for all it's worth—competition and pricing in the Australian dairy industry*, May 2010, p. 1.

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- increased transparency of government investigations (for example, by the ACCC) and improved communications regarding the progress of investigations; and
  - the long term viability of the dairy industry in some production regions.

1.22 Given the clear overlap between the issues covered, the findings and recommendations contained in these reports remain pertinent to understanding the challenges facing the dairy industry presently, and will be drawn on where relevant to this inquiry.

### ***ACCC report into the dairy industry***

1.23 Around the same time as the Senate referred this inquiry, the government announced that it would also task the Australian Competition and Consumer Commission (ACCC) to hold an inquiry into the competitiveness of prices, trading practices, and the supply chain in the Australian dairy industry. The matters to be taken into consideration include:

- the nature of competition between processors for both the acquisition of raw milk and the supply of processed milk and dairy products;
- the nature of retail pricing arrangements for milk and dairy products, and their impact up the supply chain;
- the effect (direct and indirect) of domestic retail and export prices, and level of domestic and overseas demand, for Australian processed milk and dairy products on dairy producers and processors;
- the nature of commercial relationships between dairy producers and acquirers of raw milk and the impact of corporate structures adopted (including cooperative structures) upon on these relationships;
- the mechanisms used by acquirers of raw milk to determine prices paid when acquiring raw milk and the transparency of those mechanisms;
- the availability, transparency and accessibility of market price information, and its effectiveness for forecasting movement in farm gate milk prices;
- the terms on which raw milk is acquired from dairy producers and the means by which such terms are agreed;
- the allocation of commercial risk across the dairy supply chain;
- the role of collective bargaining in the dairy industry and its effectiveness;
- the existence of, or potential for, anti-competitive conduct and the possible impacts of any such conduct on businesses within the supply chain; and
- any other factors affecting the farm profitability.<sup>3</sup>

1.24 The ACCC dairy inquiry is due to report by 1 November 2017.

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3 The Hon. Scott Morrison (Treasurer), *Inquiry into the competitiveness of prices, trading practices and the supply chain in the Australian dairy industry*, 27 October 2016.

1.25 While the committee welcomes the ACCC inquiry and looks forward to its findings and recommendations, it notes that the previous Senate Economics References Committee inquiries in 2010 and 2011 recommended that many of these issues be further investigated. Had this occurred, it may be that the events of 2016 could have been avoided or at the very least, the impacts of these events reduced.

1.26 The committee encourages the ACCC to consider the evidence and recommendations of this inquiry in formulating its findings and conclusions.

### **Structure of report**

1.27 This report comprises six chapters, including this introductory chapter:

- Chapter 2 provides an overview of trends and challenges facing the dairy sector.
- Chapter 3 focuses on raw milk pricing and supply contracts.
- Chapter 4 looks at the effect of major retailers on the raw milk price.
- Chapter 5 discusses the retrospective price step-down in 2016.
- Chapter 6 explores the role government should have in supporting the dairy industry.