

The Western Australian Farmers
Federation (Inc)

Submission

To

ACCC Inquiry into the Competitiveness of
Retail Prices for Standard Groceries.

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Prepared by:-

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The Western Australian Farmers Federation (Inc) (WAFarmers) is WA's largest and most influential rural lobby and service organisation.

WAFarmers represents West Australian farmers from a range of primary industries including grain growers, meat and wool producers, horticulturalists, dairy farmers and beekeepers plus rural small business owners.

It is estimated that collectively our members are major contributors to the \$6.1 billion gross value of production that agriculture in its various forms contributes to Western Australia's economy (WA Agri-Food Industry Outlook – August 2005).

Additionally, through differing forms of land tenure, our members own, control and capably manage many millions of hectares of the State's land mass and as such are responsible for maintaining the productive capacity and environmental well being of that land.

1. Introduction

Australian consumers are currently experiencing a bout of food inflation that has not been seen since the 1970's. This food inflation is by no means new, as it is a factor of supply and demand, and Australia is not alone in this experience as it is affecting the rest of the world.

The catalyst for the rise in food prices has been prolonged drought in many areas of Australia, with the last two years having a dramatic impact. Moreover this dryness has been experienced in other parts of the world.

The background causes for this 'food inflation' are varied (population growth, decreasing arable land etc) but much of it comes down to the extended period of economic growth and subsequent affluence that has been experienced globally. This growth has come at a stage when the world's food supply has been plentiful, and thus for an increasing number of people reasonably inexpensive. Rising incomes worldwide have enabled some 3 or 4 billion low-income consumers to move up the food chain, consuming more poultry, pork, beef, milk, eggs, and farmed fish.

What is becoming clear is the importance of grain to the whole process. About half of all grain is used for human consumption, about a third is used for animal feed, and about 17% is used for biofuels. While human consumption of grain has been fairly steady, it has been the indirect consumption of grain in food and fuel that has grown.

The three well known Boards of Trade in the US, Minneapolis, Kansas and importantly Chicago, are becoming the closest thing we have to a measure of the world's food supply. Unfortunately for consumers the wheat futures contracts (wheat being the key indicator, the \$US dollar of grains if you like) that trade on these exchanges have been skyrocketing and the world stocks to use ratio has been falling commensurately.

Despite continued dryness, and the rise in the cost of inputs, due largely to the massive shift by farmers to grain worldwide, grain farmers have not been as confident about their immediate future as they are now. A recent article in WA had one grower preparing to put in 100,000 hectares of crop for the 08/09 harvest, with reports it will be the biggest crop ever planted in Australia by an individual farming enterprise.

On one hand WAFarmers welcomes the high prices as our members who can grow grain are seeing better returns than they have for many years, but many of our members are not only suffering from the price of grain they need to feed stock, but the age old farmers problem of being unable to pass the costs up the chain.

Since the Second World War the decline in farmer's terms of trade has been a long standing characteristic of Australian agriculture. This factor has become even more pronounced since the early 1970's. As a result there has been a steady decline in the numbers of farmers, or as the government politely refers

to it, there has been a process of 'rural adjustment'. This has been exacerbated by a boom and bust cycle, that has seen more bust than boom in recent years due to climate and commodities prices.

Unsurprisingly with less of us living in rural areas and more living in the cities, there is not only less understanding of farming practices by the majority of the population, but also a greater ignorance of costs to farmers of production and the value they receive in the supply chain.

WAFarmers primary message that it wants to convey to the ACCC, is that this Inquiry into grocery prices will only be a success if a way can be developed to provide consumers with a greater understanding of the overall supply chain costs. For too long people have been willing to accept, drought or 'seasonal variation' of some kind or another as the reason for grocery price rises, but for many farmers price rises on the supermarkets shelves (and by no means is it confined to supermarkets) do not mean higher prices at the farm gate. Without this knowledge any rhetoric emanating from the supply chain above the farmgate about price rises due to 'seasonal variation' will be given substance.

2. Case Studies

Dairy in WA

In 2000 the Australian dairy industry was deregulated, this saw prices regulated by supply and demand as opposed to government intervention. In Western Australia the dairy sector is relatively small compared to the dairy powerhouse of Victoria.

Following deregulation heavy price cutting on milk by the chains represented a grab for market share from independents (many chains used milk as a 'loss leader'), but it also cemented into place the subservience of the processors to the big chains. This reduced processors to supplying milk at or near cost to the chains. Milk vendors, whose main business is servicing the independent sector, became innocent casualties, caught in the crossfire, as the independents lost market share, although this has been somewhat tempered in WA, as the market domination of the two major retailers, Woolworths and Coles, is not as complete as in the Eastern states. However it became clear that while price cutting pressures are applied at the market level, the loss in retailer margin was being passed down the chain to farmers.

A study by Dairy Australia titled Australian Dairy Industry In Focus, demonstrates the use of milk to gain market share by the chains. In 2001/02 branded milk retailed at \$1.36 per litre (weighted average across all pack sizes), while generic (supermarket home brand) milk traded at \$1.08. In 02/03 the difference was \$1.40 to \$1.11, in 03/04 it was \$1.42 to \$1.11, in 04/05 it was \$1.47 to \$1.10, in 05/06 it was \$1.52 to \$1.11, and in 06/07 it was \$1.56 to \$1.13. Currently generic brands which are supplied by the same vendors who produce the branded milk, hold over 80% of the market share. The

supermarkets may argue that the above data is testament to their ability to drive positive results for consumers, however WAFarmers believes that by using their market power in this manner the supermarkets decrease the ability of other segments of the supply chain to invest in their business, which in turn affects future supply.

At the time of deregulation WA had about 440 dairies, this has now shrunk to about 240. This has seen the production of milk fall from about 400 million tonnes in 2002/03 to about 320 million tonnes in 06/07. Interestingly the long trend of 'rural adjustment' hasn't usually seen such a negative impact in the level of production, nationally production has remained relatively constant since 03/04 (with a recent dip due mainly to drought).

While the consumption of drinking milk has been steadily declining in Australia, rapid population growth in WA has seen consumption of drinking milk rise from 190 million litres in 03/04 to 230 million litres in 06/07. It is expected that drinking milk consumption will increase further, and the situation has already arisen that drinking milk has had to be trucked in from the Eastern States to augment supply.

In 03/04 & 04/05 farmers on average received 27.3 c a litre, in 05/06 this increased to 29c, in 06/07 it was 32c, and for this year it is expected to average 39 cents. ABARE suggest that this will rise to a national average of 54c a litre in 08/09 (although on a long term trend I would expect the figure to be closer to 50 cents in WA).

While on face value those figures represent an almost 80% increase in income, many farmers believe that the price they are receiving now is only the equivalent to the price they were receiving in 1999 before deregulation, and that does not take into account the massive rise in input costs. The fact that the supermarkets have been able to maintain the price at such a low level would seem to confirm this, as does data which suggests that supermarkets in Australia sell milk at very low margins compared to the US and the UK. However the choice by supermarkets to use this policy has left many dairy farmers questioning their futures.

Since 1999 (and in particular the last three years) there has been a significant rise in input costs, the cost of feed, fertiliser, fuel and labour (particularly here in WA) has virtually doubled. The last two years have seen massive increases in feeding costs, as more cows needed to be hand fed, and as we have seen there has been a 100% rise in the price of fodder grain in the last two years.

Grain

Wheat (and other grains) has doubled in value in the last two years, and as I have previously explained it has become the apex of the world's food supply, so it is clear that everyone will seek to lay blame for the current food inflation we are experiencing on the price of wheat. Although this is hardly surprising

as the slightest seasonal variation or volatility has been enough of an excuse for price rises.

While the Reserve Bank of Australia has pointed out that in the past droughts had little effect on the cost of food, this drought has been different, we still hold concerns that drought has resulted in some element of price gouging. Farmers also hold grave concerns that city residents are prepared to accept the drought excuse too easily, when it affects everyone's hip pockets.

Our members continue to be frustrated with rises of up to 70c cents a loaf of bread being blamed on high grain prices. Rises in grain prices came down to an increase of about 10c a loaf. If wheat is \$200 a tonne, it costs 10.7c a loaf. If it is \$250 a tonne, as it was 12 months, ago that's 11.35c a loaf; and if it is \$400 a tonne, then it costs 21.4c a loaf." It is obvious to farmers that the price rise has more to do with fuel, energy and labour costs and other inputs.

However due to commercial in confidence issues there is little chance that we will know just where the added cost, and/or margin lies.

3. Conclusions

The two studies above show contrasting concerns in regards to pricing.

In regards to dairying the pricing issue has been a protracted issue for a long time. Dairies are expensive to set up and prices would have to rise significantly for people to make that sort of capital investment, and despite increased demand those farmers leaving the industry in WA are not being replaced. It is true that deregulation has seen farmers become more efficient and flexible, but there is still an inability to pass costs up the chain. If either the market or the consumer is unwilling to share more of the cost it is hard to see this changing. There are a number of costs that are affecting interest in dairying, namely water and land values, but without increased margins the WA dairy industry may lose critical mass.

In regards to grain similar issues to dairy exist, the price spikes that are being currently experienced are by no means new phenomenon, but they have occurred fairly infrequently and not usually with such volatility. For the last ten years many grain farmers have been questioning their viability and the numbers of grain farmers in WA has halved in that time. There concerns are only heightened when they hear about price rises due to drought, but are receiving very little extra for their grain.

These issues are concerns in common to all farmers, and in the past this has been all part of the boom and bust cycle of agriculture.

Unfortunately we are now facing a period of booming input prices, and widespread shortages. Australia has been sheltered somewhat in the past by our small population in regards to the size of our surplus agricultural production, but more than ever our agricultural prices are effectively set by world demand, and that is growing. WAFarmers is keen to see the

government explore policy that can make smooth the road as it were, we are not arguing for direct government intervention in the form of marketing boards, as has been the policy direction in the past, but we are keen to see how this Inquiry can help to make agriculture more sustainable.

We need help from the government to build a bridge between the city and rural Australia, to the farming side of it, to demonstrate to city people how farmers are trying to produce food at affordable prices consistently year round for residents in the city, and to look at ways this can continue.

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WAFarmers request the opportunity to provide more information to the Inquiry verbally at a later stage.