Australian Government

Department of Agriculture
and Water Resources

Ms Gabrielle Ford
A/g General Manager
Agriculture Unit
Australian Competition & Consumer Commission

Via email: gabrielle.ford@accc.gov.au

Dear Ms Ford

Thank you for the opportunity for the Department of Agriculture and Water Resources to make a submission to the ACCC Dairy inquiry.

Please find attached the department's submission to the Senate Economics Legislation Committee Inquiry in the Dairy Industry in October 2016 which is relevant to the ACCC's Dairy inquiry.

I can confirm that the submission contains only public information and may be used accordingly.

Yours sincerely

Jo Grainger
Assistant Secretary
Wool, Dairy, Wine, Small & Emerging Industries

12 December 2016

T +61 2 6272 3933
F +61 2 6272 5161

18 Marcus Clarke Street
Canberra City ACT 2601

GPO Box 858
Canberra ACT 2601

agriculture.gov.au
ABN 24 113 085 695

Since deregulation in 2000, the Australian dairy industry has been through a period of structural adjustment, resulting in productivity improvements and a move towards fewer, larger, more efficient farming enterprises and a more diverse and export-focussed processing sector.

In the past year, the industry has experienced a downturn, largely driven by deteriorating international market conditions. The combination of the closure of the Russian market and an increase in production from the European Union has resulted in increased competition in other dairy import markets, including Asia, and has driven down world prices for dairy commodities. Such downturns are not unusual for export-exposed agricultural industries, but do pose challenges for those affected.

In response to deteriorating export market conditions and retrospective price step-downs by some processors during the 2015–16 season, the government is working with stakeholders to find industry-led solutions to the challenges facing the dairy industry. This includes bringing stakeholders together to canvass problems and potential options to address these challenges. Work has also commenced on options to provide more timely price signals to farmers.

Despite the current challenging operating environment for the sector, industry fundamentals are sound and long-term prospects remain good. This is evidenced by continuing capital investment aimed at improving on-farm efficiencies, and greater value-adding in the processing sector to take advantage of increasing export opportunities arising from Australia's free trade agreements.

More detailed information about the Australian dairy industry is provided at **Attachment A.**

2015–16 MILK PRICE STEP-DOWNS AND GOVERNMENT RESPONSE

In April–May 2016, Murray Goulburn and Fonterra reduced the farm gate price paid to their dairy suppliers in Victoria, South Australia and Tasmania. This situation has continued to present challenges for some dairy farmers throughout 2016–17.

On 25 May 2016, after consultation with the dairy industry, the Australian Government implemented a $579 million support package to help Murray Goulburn and Fonterra suppliers respond to the retrospective step down in prices. This package includes:

- Access to up to $555 million for Dairy Recovery Concessional Loans ($55 million in 2015–16 and $250 million per year in 2016–17 and 2017–18) for suppliers affected by the Murray Goulburn and Fonterra retrospective price reductions
- $20 million to fast track the upgrade of the Macalister Irrigation District
- $900 000 for an additional nine rural financial counsellors in Victoria, Tasmania, South Australia and New South Wales
- $900 000 for Dairy Australia's 'Tactics for Tight Times' programme to increase dairy farm business management skills and business resilience
- Assigning 18 more Department of Human Services employees to help process the increase in Farm Household Allowance applications from within the dairy industry
- Appointment of a Department of Human Services Dairy Industry Liaison Officer
- Redirection of two Department of Human Services Mobile Service Centres to dairy regions.

This is in addition to assistance available to farmers, farm businesses and rural communities in hardship more broadly, including drought support. Key measures include:

- Farm Household Allowance, which provides eligible farmers and their partners who are experiencing financial hardship with up to three years of assistance and support to improve their long-term financial situation. The Farm Household Allowance includes an allowance paid fortnightly at a rate equivalent to Newstart Allowance (or Youth Allowance for those under 22 years), a Health Care Card, and support through a dedicated case manager to help recipients assess their situation and develop a plan for the future.
- Free rural financial counselling to eligible farmers (as well as fishing enterprise operators, forest growers and harvesters) and small related enterprise operators suffering financial hardship, to manage the challenges of industry change and adjustment. The 2016–17 Budget included an additional $7.07 million over four years to 2019–20 to the Rural Financial Counselling Service to provide additional services to clients in drought-affected regions. This builds upon an additional $1.8 million for the Rural Financial Counselling Service through the Agricultural Competitiveness White Paper.
- Drought-related concessional loans, which provide concessional finance to drought-affected farm businesses to restructure existing debt, fund operating expenses and undertake preparedness and recovery activities.

As at the beginning of October 2016, more than 4 600 farmers and their partners are receiving Farm Household Allowance. From 2 May 2016 to 30 September 2016, the number of dairy industry customers receiving Farm Household Allowance increased from 255 to 476. The majority of the increase is attributable to dairy farmers and their partners in Victoria, with an increase of 206 recipients.[1]

Since September 2013, the Australian Government has provided more than $825 million in drought and rural assistance, including more than $502 million in Farm Finance, Drought, Drought Recovery and Dairy Recovery concessional loans to 957 farm businesses in need.

Further information on these measures, as well as other assistance and support for farmers, farm businesses and rural communities, is available on the department's website.

Dairy Symposium: industry led solutions

The government is working with stakeholders to find industry-led solutions to the current dairy situation. A dairy symposium was convened by the Deputy Prime Minister on 25 August 2016 to discuss issues affecting the industry, including how to improve risk management across the dairy supply chain. Off the back of the symposium, on Tuesday 27 September Australian Dairy Farmers and Australian Dairy Products Federation convened a workshop with state farmer organisation Presidents and dairy processors to begin the process of improving contractual arrangements and to investigate options to share risk across the supply chain. For example, milk processors have agreed to the development of a code of conduct with dairy farmers to ensure more transparent and less ambiguous contracts.

[1] Information is approximate, as dairy can be a part of mixed farming enterprises.

Australian Competition and Consumer Commission and Australian Securities and Investments Commission Inquiries

Following the symposium, the government announced that the Australian Competition and Consumer Commission (ACCC) will conduct an inquiry into the dairy industry, to begin in November 2016. The ACCC inquiry will investigate sharing risk along the supply chain, supply agreements and contracts, competition, bargaining and trading practices in the industry, and the effect of world and retail prices on profitability. The inquiry, to be led by the ACCC's Agriculture Unit will have the power under Part VIIA of the *Competition and Consumer Act 2010* to compel companies to provide information while protecting commercial interests.

The ACCC is also investigating the retrospective price cuts announced by Murray Goulburn and Fonterra in April and May 2016. This regulatory investigation will determine whether the processors have engaged in misleading, deceptive or unconscionable conduct under sections 18 and 21 of Schedule 2 of the *Competition and Consumer Act 2010*. The investigation is a priority for the ACCC.

The Australian Securities and Investment Commission is also considering whether Murray Goulburn met the continuous disclosure obligations for information notified to the stock exchange.

Dairy Commodity Milk Price Index

The government made an election commitment to make available up to $2 million to establish a commodity milk price index. The aim is to improve transparency in milk pricing and provide more timely price signals to farmers. The department is examining existing commodity price information and consulting with the dairy industry on possible approaches.

$1 PER LITRE MILK

There is concern from some parts of the dairy industry that the introduction of $1 per litre milk in January 2011 has reduced profit margins for milk processors and farm gate returns for dairy farmers. Commercial-in-confidence contracts between milk processors and the major retailers are complex and relate to a range of products including milk, butter, cheese and yoghurts—both branded and private label.

It is expected that the forthcoming ACCC inquiry into the dairy industry will investigate this issue further.

LEVY

In the period since the Murray Goulburn and Fonterra price step-downs, some stakeholders have suggest an emergency, temporary levy (e.g. fifty cents per litre) on the retail sale of milk, to assist farmers to return to profitability.

The Australian government would need to be satisfied that the benefit to industry from such a levy would outweigh any other industry or public detriment.

For example, the imposition of a levy on domestic drinking milk risks distorting market signals along the dairy supply chain, being a disincentive to improved productivity, and impeding international competitiveness. Further, it may have the unintended consequence of reducing consumption of fresh milk, damaging the profitability of dairy farmers and squeezing supply chain margins further. Such a levy would also make it difficult for Australia to advocate against domestic dairy support measures in other countries when negotiating trade agreements.

The Department's understanding is that there is currently little support from the dairy industry and processors for a levy.

ATTACHMENT A

THE AUSTRALIAN DAIRY INDUSTRY

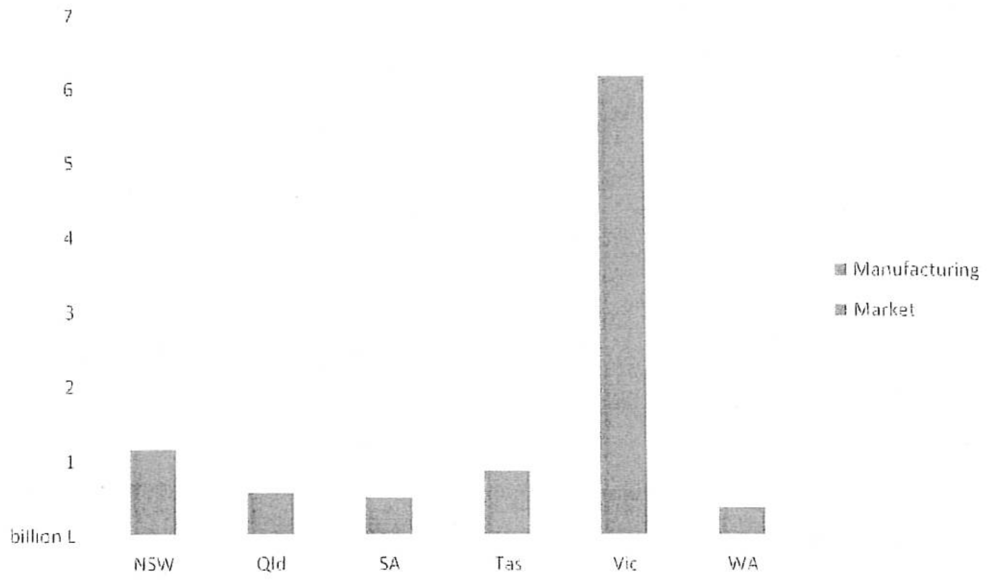
Since deregulation of the dairy industry in 2000, the number of dairy farms in Australia has fallen by around 47 per cent. This fall reflects a consolidation of the industry to larger farming operations. The overall size of the dairy herd and total production of milk has varied over the same period. In 2015–16 total milk production was 9.5 billion litres. This is a similar level to that produced in 1997–98 and 2006–07. Average milk production was higher in the period between 1998–99 and 2005–06; and lower between 2007–08 and 2013–14. Thirty-four per cent of Australia's milk production was exported in 2014–15, mostly in the form of manufactured dairy products.

Cow numbers fell by approximately 576 000 head to around 1.6 million head between 2000-01 and 2010-11, largely as a result of drought. A period of herd rebuilding has since ensued, with total herd numbers growing to an estimated 1.7 million head in 2015–16.

MILK PRODUCTION

Milk production in Australia differs between states, with production largely concentrated in the temperate, southern states. Victoria accounts for 65 per cent of total Australian milk production with over 90 per cent of the state's production being utilised in manufacturing dairy products. In contrast, Queensland accounts for only 4 per cent of total production, with virtually all production being sold as drinking milk.

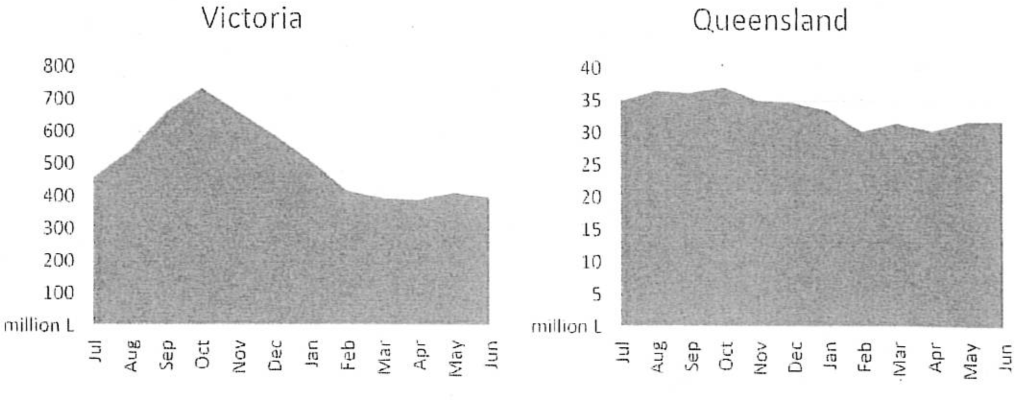
Share of market and manufacturing milk by state, Australia, 2015–16



source: ABARES

Production in the southern states is highly seasonal, reflecting the predominantly pasture-based nature of the industry. Production peaks in October, tapers off until late-summer, and then flattens out through winter. This production cycle allows farmers to operate at a lower cost of production and the transformation of milk into longer shelf-life products allows for maximum milk utilisation within the seasonal cycle. In northern states, this seasonality is less pronounced given the predominance of market milk production, which requires a consistent year-round supply of fresh milk.

Seasonality of milk production in Victoria and Queensland, 2015–16



Source: Dairy Australia

ABARES forecasts Australian milk production to fall 2 per cent to 9.3 billion litres in 2016–17. Low farm gate milk prices and relatively strong saleyard prices for cows are expected to result in producers increasing their culling of less-productive cows, which is forecast to result in a 2 per cent contraction of the milking herd to 1.66 million head.

FARM GATE PRICE

Farm gate milk prices in Australia are deregulated and strongly influenced by global dairy commodity prices and exchange rate movements. Up to 75 per cent of Australia's milk production is exposed to world prices for dairy products such as butter, cheese and milk powders. According to Dairy Australia, over the past three decades more than 90 per cent of the annual variation in farm gate milk prices is explained by movements in average export returns.

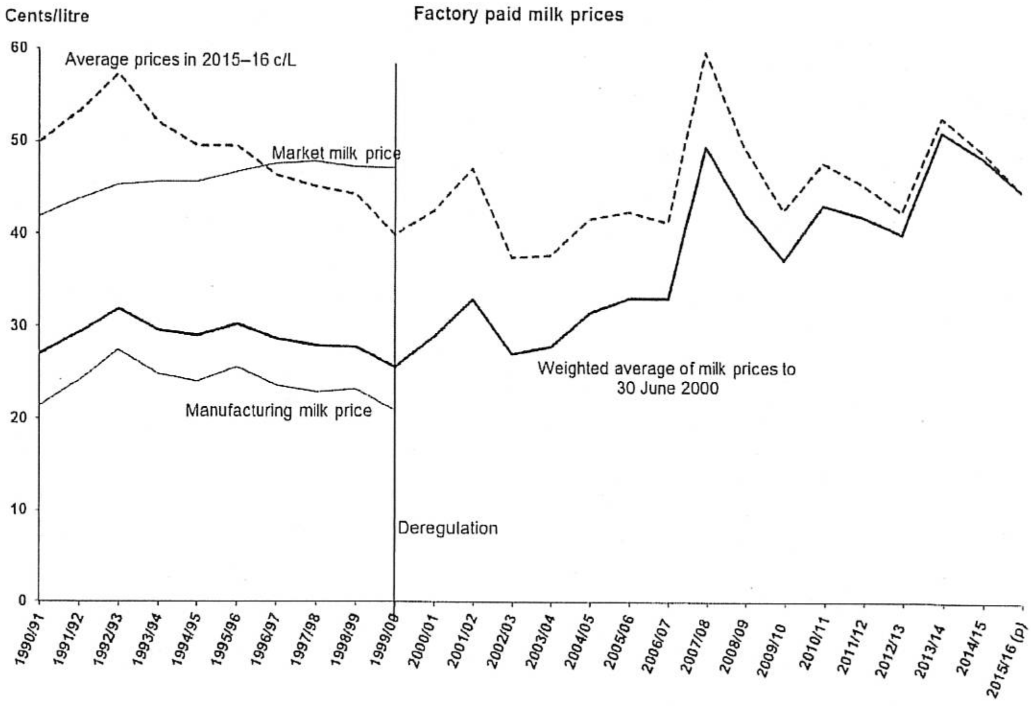
Farm gate prices vary between manufacturing companies with company returns being influenced by market and product mix, marketing strategies, the utilisation of factory processing capacity and exchange rate hedging policies. Farm gate prices also vary across Australia: in the southern regions farmers receive a 'blended' price that incorporates returns from the milk used in manufactured dairy products. In the northern and western regions of Australia, where production is predominately focused on the domestic drinking milk market, higher farm gate prices are generally paid to ensure year-round supply.

Farm gate prices can also vary significantly between farmers as processors operate a range of incentives and penalty payments relating to milk quality, productivity or volume levels, and provision of year-round supply.

The weighted average farm gate milk price is forecast to fall by two per cent in 2016–17 to 42 cents a litre, reflecting forecast lower year-on-year average world prices for traded dairy products. Many processors have set opening prices for 2016–17 that are lower than the previous year. However, there has already been an early step–up payment from some processors such as Murray Goulburn following successive increases in Global Dairy Trade auctions. World dairy markets can be highly volatile and farm gate milk prices are not expected to rise significantly until there is further improvement in global prices.

Average farm gate milk prices have been volatile since deregulation in 1999–00. However, despite the step-down from processors during the year, the average farm gate milk price in 2015–16 is estimated to be only slightly below the long term average achieved over the period from 1999–00 to 2015–16 in real terms.

Farm gate milk prices from 1990–91 to 2015–16

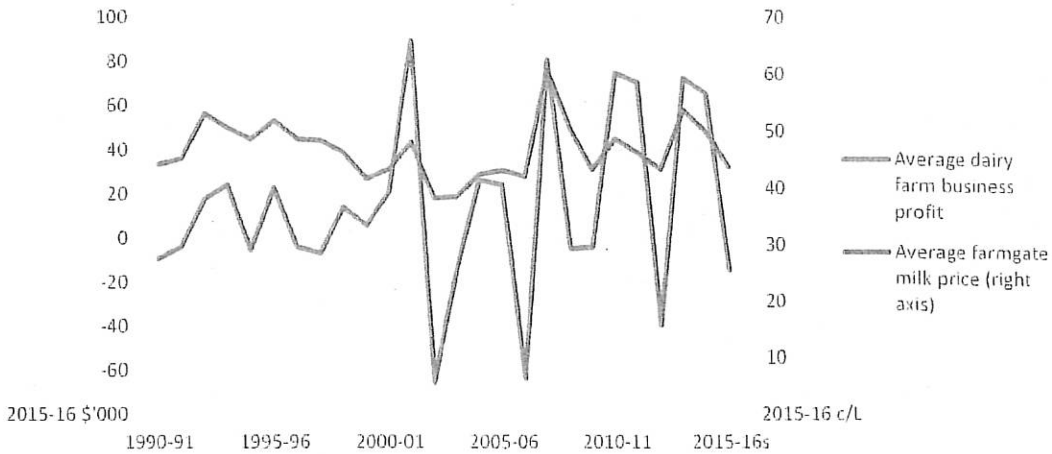


source: Dairy Australia

FINANCIAL PERFORMANCE OF AUSTRALIAN DAIRY FARMS

Average dairy farm cash income and farm business profit have been highly variable. In the 16 years since deregulation, dairy farms are estimated to have made net profits in 9 years and losses in 7 years on average. However, the magnitude of profits and losses have increased significantly since deregulation. The average dairy farm business loss in 2015–16 is estimated to be $14 000. This compares with average losses, in real terms, of $40 000 in 2012–13, $4 000 in 2009–10 and $64 000 in 2006–07.

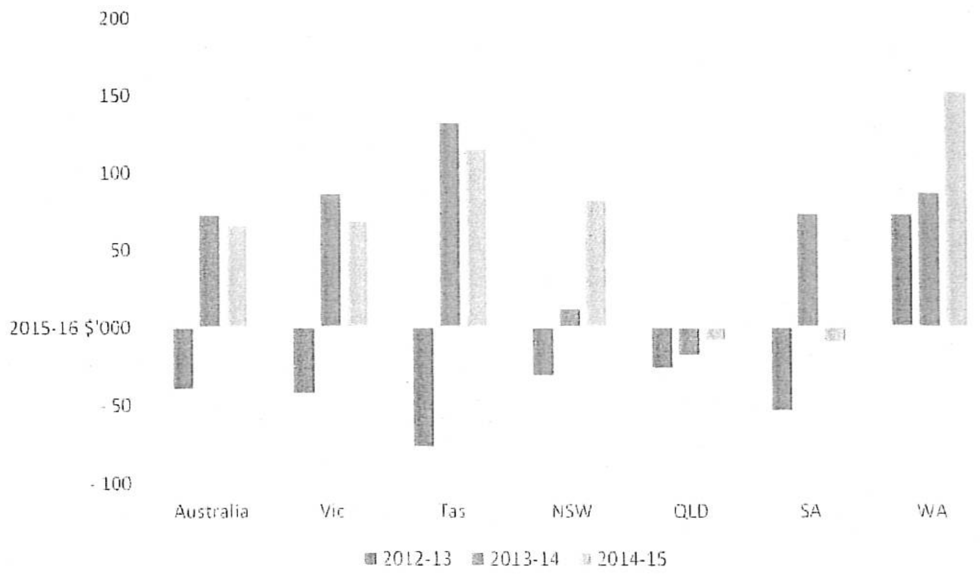
Average dairy farm business profit and farm gate milk price, Australia, 1990–91 to 2015–16



s ABARES estimate

Dairy farm financial performance varied across states. Given the high percentage of milk sold to processors who manufacture dairy products, Victorian and Tasmanian farmers' profits are more susceptible to changes in world prices. In 2013–14, when global dairy prices were relatively high, Victorian and Tasmanian dairy farm business profits averaged well above the national average. In 2014–15, farm incomes in these states reverted closer to the national average as world prices began to decline, while farm business profits averaged higher year on year in New South Wales, Queensland and Western Australia.

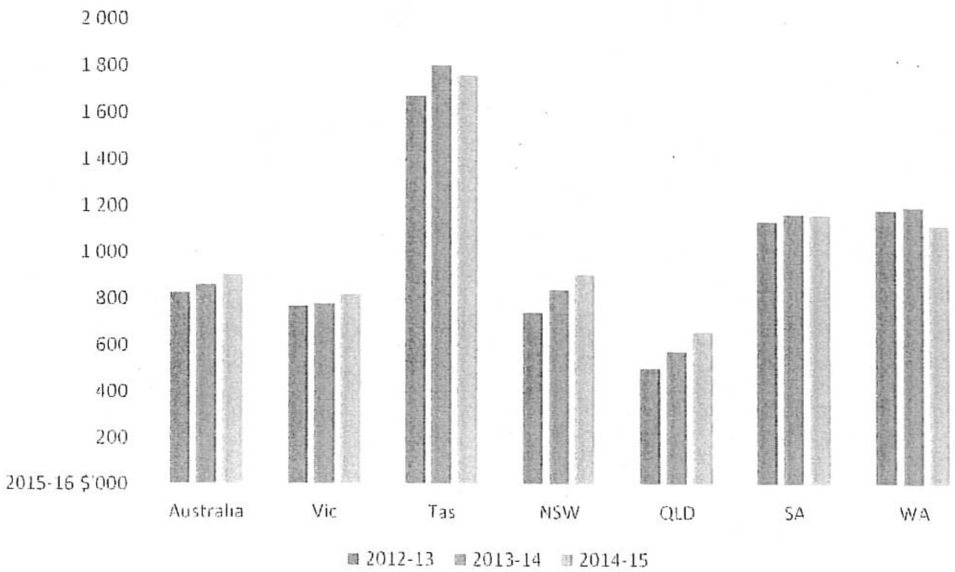
Average dairy farm business profit by state, Australia, 2012–13 to 2014–15



Average dairy farm debt increased from $346 000 in 1999–2000 to $861 500 in 2014–15 in real terms. Increased borrowing by individual farms for land purchases or new on-farm infrastructure and equipment contributed to the increase in average debt. Demand for ongoing working capital also rose with increases in average herd size and the mechanisation and intensification of dairy enterprises. The increase in average debt was also a result of increases in average farm size as smaller farms with lower average debt left the industry and raised the average for remaining farms.

Tasmanian dairy farms, on average, have the largest debt of all states at almost twice the national average. Conversely, Victorian farms average below national average debt levels, although these have been increasing since 2010–11.

Farm debt for Australian dairy farms by state 2012–13 to 2014–15



OUTCOMES FOR DAIRY IN AUSTRALIA'S FREE TRADE AGREEMENTS

Singapore (2003)	Tariffs were eliminated on all goods from entry into force for both countries.
United States (2004)	Duty free access to tariff rate quotas for butter, some cheeses and other dairy products.
Thailand (2004)	Tariffs on yoghurt and dairy spreads eliminated from 2010. Tariffs on cheese were reduced on entry into force and will phase to zero in 2020.
Chile (2008)	Tariffs on most agricultural goods were eliminated on entry into force in 2010. Remaining tariffs on agricultural goods (with the exception of sugar) were eliminated by 2015.
ASEAN and NZ (2009)	Tariffs on processed cheese exports to Malaysia were eliminated on entry into force in 2010.
Malaysia (2012)	Australia obtained a liberalised licensing arrangement for liquid milk exporters, allowing access for higher value retail products.
Korea (2014)	A range of preferential Australia-only quotas for dairy, growing annually. Gradual elimination of out-of-quota tariffs on certain products by up to 2033.
Japan (2015)	Immediate Australia-only duty-free quotas for cheeses for processing and shredding. Tariffs on casein, lactose, albumen, and milk protein concentrates were eliminated on 15 January 2015. Preferential Australia-only quotas for processed and grated/powdered cheeses, ice-cream and frozen yoghurt.
China (2015)	Elimination of tariffs on infant formula, ice cream, lactose, casein and milk albumins by 1 January 2019. Elimination of tariffs on liquid milk, cheese, butter and yogurt by 1 January 2024. Elimination of the tariff on milk powders by 1 January 2026.
Trans-Pacific Partnership	A range of tariff and quota concessions on dairy products with major trading partners once TPP enters into force.