SUBMISSION ON ACCC ISSUES PAPER

Please find below (comments marked in red) the submission from Farmer Power on the ACCC Issues Paper that is put out for comment at the start of its Inquiry into the Dairy Industry.

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The Australian dairy industry

Industry overview

Dairy is Australia's third largest agricultural commodity in terms of farmgate value, and fourth in terms of export value.[1] In 2015-16, 9.54 billion litres of milk was produced nationally, which according to Dairy Australia was processed into cheese (30 per cent), skim milk powder and butter (29 per cent), drinking milk (fresh and long-life UHT) (26 per cent), whole milk powder (6 per cent) and a range of other products (9 per cent) such as yoghurts, custards, dairy desserts, whey proteins and nutraceuticals. Production exceeds domestic consumption, so access to export markets is critical: around 34 per cent of total Australian dairy production was exported in 2014/15, including 65 per cent of manufactured dairy products (compared to around 6 per cent of drinking milk).

If the ACCC is to understand what is happening to the dairy industry it needs to update this picture and project into the future. In the first six months of the 2016-17 financial year we know that milk production has dropped by around 11% nationally and around 20% in some of the major exporting regions. Farmer Power predicted last financial year that over the 12 months to June 2017 there was likely to be a 20% drop in milk production unless there was urgent action to address the situation, and unfortunately this prediction looks conservative.

If there was a 20% drop in production this would pull back Australia's milk production to 7.6B litres (an unprecedented low). Given that domestic demands for dairy products take precedent, and domestic demands are steadily increasing, this would reduce the amount of milk going into export products to around 1B litres, or 13% of total milk production. This could translate into a decrease of $2B per year in Australia's net dairy export earnings. If the increasing volume of dairy imports is taken into account (particularly cheese from the US and New Zealand, some of this seemingly taking the form of subsidised dumping) then Australia is on track to become a net importer of dairy products within the next year

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[1] ABARES 2013/14 from Dairy Australia *Australian Dairy Industry In Focus 2015*, p. 5

Continued inaction by the Government will see a continued decline. Processing plant closures are already happening, which means that processors will be operating plant below capacity, weakening their ability to pay farmers more than the cost of production.

Approximately 66 per cent of Australian milk production is sold domestically in the form of liquid milk and manufactured products. Historically, this number has varied from around 40-60 per cent[2]: declining production and population growth (rather than significant increases in per capita consumption) have resulted in an increasing proportion of production being sold on the domestic market. Long term trends for per capita consumption of drinking milk and butter/butter blends are fairly stable, while consumption of cheese and yoghurt has gradually increased. Around 94 per cent of drinking milk is consumed on the domestic market. A range of dairy products are also imported.

In relation to the predictions above, the proportion of milk production being sold domestically is likely to reach 87% in the next six months, and continue rising. In 2017-18 Australia is likely to be unable to meet domestic demands for dairy products. In the not too distant future Australian consumers will have to switch from drinking fresh milk produced in Australia to drinking UHT milk imported from New Zealand.

Australian dairy production is concentrated in the south-eastern corner of the country and in coastal areas. Information provided by Dairy Australia shows that around 66 per cent of production occurs in Victoria, 12 per cent in New South Wales, 9 per cent in Tasmania, 6 per cent in South Australia, 5 per cent in Queensland and 4 per cent in Western Australia. The concentration of farms in regions with a climate suited to pasture-based production reflects the fact that the Australian dairy industry has traditionally maintained a low cost base, enabling production beyond domestic demand for sale into global markets.

Again, this picture is out of date. The latest data shows increased production in Queensland, while the most severe drops in production are being seen in Victoria. This is a direct result of the clawback in milk earnings executed by Murray Goulburn and Fonterra (and an equivalent more recently effected by National Dairy Foods) which forced dairy farmers to cull their herds, and in many cases quit the industry.

Australian dairy farms are generally owner-operated small and medium size enterprises, and have operated in a fully deregulated market since 2000 (although the government continues to be involved in the administration of food standards and food safety assurance systems).

We dispute that the market can be described as “fully deregulated” when dairy farmers are obliged to pay an average of $8,000 per year to Dairy Australia, there are regulations which result in all the risks in the dairy supply chain being borne by the dairy farmers, there is a lack of transparency or accountability in pricing, and a range of restrictive practices prevent dairy farmers from effective negotiation with processors.

Consistent with trends in other agricultural industries, there has been a shift to fewer, larger and more efficient dairy farms. In the period from 1999/2000 to 2014/15, milk production declined by 10 per cent, the number of cows in the national herd by 20 per cent (to 1.74 million), and dairy farm numbers by more than 50 per cent (to 6,128). There was also increased average production per-cow during this time.[3]

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[2] ibid., p.19

[3] *In Focus 2015*, p. 6-14

People who know little about the practicalities of dairy farming continue to misinterpret these data. The shift to larger dairy farms has occurred as smaller family farms are forced out of the business, depressing land prices and enabling farms to be bought up cheaply by more wealthy farmers. This trend seems to be supported by the Government but it is not necessarily desirable for the industry, or for rural communities. The increase in milk production per cow has to be seen in the context of the following:

- older less productive cows being culled earlier, which improves short term cash flow but results in the economic returns per cow over her lifetime being reduced; and

- recent New Zealand research validates the fact that more intensive milk production is more expensive, so that these farmers make an even heavier loss per litre of milk if the farm gate milk price is less than the cost of production. The New Zealand data suggests that milk prices would have to virtually double to make intensive milk production viable, whereas lower intensity production based largely on pastures would require an increase of only around 20% on the current price to become financially sustainable.

The decline in farm numbers has not occurred evenly across Australia, with the south-east of Australia being the least affected. These states are less reliant on supplying the drinking milk markets, with the manufacturing of long shelf-life products allowing greater access to export markets. The predominantly pasture-based nature of the industry in this region generates a production peak in October (reflecting a majority of producers calving in spring), tapering off through summer and into winter. Relatively low-cost rainfed pasture enables product from these regions to compete in export markets, although recent droughts and processor demand for flatter production have seen costs increase as producers have increased purchases of feed inputs such as grain and concentrates.

Again, these data do not reflect the current situation, and need updating. The decline in farm numbers is now greatest in Victoria. The ability to compete in export markets is highly questionable for reasons outlined below, but as production declines this becomes a non-issue as the export market is being wiped out.

Production regions that are particularly focused on domestic drinking milk have experienced more significant declines in farm numbers. These regions are in Queensland, Western Australia and parts of New South Wales and tend to be characterised by relatively stable production across the year, achieved through management of calving patterns and feed production systems. As a result, they tend to have a higher average cost of production, and also attract a higher average farmgate price.

Since deregulation in 2000 there has been no legislative control over prices, which are now set by market forces. Five major dairy processors accounted for 79 per cent of volume nationally in 2015-16, with a large number of smaller processors making up the remainder of the industry. The five largest processors (by volume) were Murray Goulburn, Fonterra Australia, Parmalat Australia Ltd, Warrnambool Cheese & Butter, and Lion Dairy & Drinks.

It is a complete myth that milk prices in Australia are set by market forces. A distinction needs to be made between prices of milk at the farm gate, export prices of dairy products and retail prices of dairy products sold in the domestic market.

In relation to the farmgate milk price, it is clear that this price is set by processors opportunistically, in a situation where dairy farmers have no effective negotiating power. The recent clawbacks are an illustration of this, as they seem to have been prompted by poor production decisions within Murray Goulburn and some questionable accounting practices. Current farmgate price setting ignores trends in both the domestic and export market.

In relation to export prices, over the past six months, global dairy prices have increased but this has not flowed on to farmers. Global data shows that Australian dairy farmers have previously been significantly underpaid in relation to other dairying countries.

(see http://www.dairyreporter.com/Manufacturers/Which-companies-pay-the-most-for-milk/?utm_source=newsletter_daily&utm_medium=email&utm_campaign=16-Jun-2016&c=p8UxEFfTDA9Xd3EARdlWua9QTvQYq4WK&p2=)

This situation has worsened in the past few months when global prices have lifted, and this has flowed on to farmers in other countries. The disadvantage experienced by Australian farmers is exacerbated by the fact that our major export competitors subsidise their farmers for about 50% of the cost of production.

As a clear demonstration of the disconnect between the Australian farm gate milk price and global dairy price movements, we note that UK dairy farmers have received a 7% price increase since September this year in response to global trends, and now receive around AUD 50c a litre (in addition to EU subsidies. This is the current global benchmark, yet Australian farmers are stuck with a price around 35c a litre being paid by most processors.

In relation to domestic retail prices, cheap homebrand milk is used as a “loss leader” promotional tool by the major supermarkets, but unlike other promotional initiatives (such as cheap petrol) the cost of this is not borne by the supermarkets, but rather passed on to the farmers. Depressed prices impact on name branded product, for which prices are suppressed in order to compete. If there was need for further illustration of how the market disadvantages the farmers, the recent consumer campaign to switch to drinking name branded milk in order to help the farmers has resulted in a significant additional return on drinking milk to the major processors, which has not been passed on to the farmers. This has been calculated as a 15% shift in purchasing patterns, putting over $700M into the supply chain.

Milk supply contracts contain relatively complex farmgate prices and payment systems with the price quoted by a buyer or processor generally being the ‘effective price’ for their ‘average supplier’, quoted as an effective price per unit ($/kg milk solids or c/L).The effective price is calculated based on payments for:

- fat content
- protein content
- a range of incentives or deductions for things such as:
    - flat supply (to encourage steady supply throughout the year)
    - scale or growth
    - quality
    - loyalty.

These contracts appear to be deliberately complex so that price transparency is avoided, and the various penalty clauses amount to unjustified theft. For example, farmers can receive nil payment for milk that is collected and used by processors for a number of reasons, with no avenue of appeal. In the current situation farmers are being penalised for not being able to supply the amount of milk initially offered, simply because producing milk does not earn enough to cover the cost of production. Some farmers have not received any payment for milk they have actually supplied to processors for the past nine months, and those that are left in the industry are only surviving by progressively selling off their cows for meat.

Issue 1 – Competition for milk

This section of the Issues Paper focuses on the level of competition between purchasers of milk at the farmgate. Milk is primarily purchased by processors at the farmgate level, although some contract processing arrangements do exist for producer to retailer direct supply relationships.

Competition between processors is critical to the functioning of the dairy industry to ensure that producers have options when selling their milk, and retailers and other buyers have options when purchasing dairy products.

In order to assess the level of competition that exists between buyers, the ACCC seeks further information about the specific sales options available to producers in their local region.

The ACCC would appreciate feedback on:

1. The level of competition between processors for the acquisition of milk, across regions
2. The ability of producers to switch between processors or other buyers.

When providing feedback, you may wish to comment on:

- The features of dairy regions. This includes the range of potential buyers, and access to and reliance on domestic or export sales.
- Why producers choose to supply certain buyers
    - How the corporate structure of potential purchasers affects this
- How the industry manages under or over supply of milk.
- The use of exclusive supply terms in contracts
- The use of loyalty and other bonuses
- Whether milk supply agreements operate on different 12-month cycles (i.e. calendar year and financial year) and the impact of this on options for switching between processors
- Processor margins. This includes information on costs of production for processors.
- The capacity of processing facilities and the factors affecting their operations
- The regularity with which processors trade milk (‘milk swaps’)
- The impact of any consolidation or vertical integration in the industry.

Dairy production used to be structured within farmer co-operatives, in which farmers had control over pricing and benefited from product sales. Over time, processing has become corporatised, so that the behavior of processors often seems to give priority to the short term financial gains of investors including shareholders rather than farmers. This is clearly short sighted, and a long term rational strategy would involve supporting sustainability of farmer suppliers, but sadly such a perspective appears to be lacking.

The only true co-operative still operating is Norco, and it is no coincidence that Norco currently offers the best price to its suppliers (around 50c per litre).

Murray Goulburn used to be a co-operative, but for the past few years it has not operated in the interests of its farmers, and the situation worsened when it changed its structure to include non-farmer shareholders through a unit trust arrangement (with guaranteed minimum returns to these non-farmer investors). There are suggestions that the clawback it announced in 2016 enabled a book entry of a "debt" owned by farmers to be posted as an asset in its balance sheet, enabling it to claim an operating profit and therefore satisfy its new non-farmer shareholders.

The loyalty of farmer-shareholders to Murray Goulburn has been sorely tested. There was significant alarm amongst many farmer-shareholders when the Murray Goulburn board decided to bid for acquisition of Warrnambool Cheese and Butter in 2014, which would have worsened its already heavy debt burden. The fact that this bid was unsuccessful avoided the anticipated risks, but the float of shares in the unit trust that occurred in 2015 appeared to be raising capital that was largely used to pay off debts incurred through massive investment in new plant for milk powder production, incurring further risks to the farmer-shareholders (manifested today as warehouses full of unsold milk powders). The value of their shares plummeted to virtually zero, and many farmers left because of perceived risk and the plummeting share value. Many farmers still remained emotionally loyal to the perceived co-operative model. However this loyalty has now been further tested by the clawback, the imposed "debt" that farmers have to repay to the company, and the fact that this debt can be avoided if they switch to supplying a different processor.

While there are strong incentives to switch at present, particularly amongst Murray Goulburn and Fonterra suppliers (as Fonterra suppliers are also able to avoid repayments of the imposed clawback "debt" by switching) there are obstacles presented by the types of contracts being offered by all processors, attempting to lock in supplies for several years. The loss of milk production is increasing the aggressiveness of processors in competing for suppliers. However this is not yet resulting in increased farm gate prices (note that Murray Goulburn has actually dripped its price further) which clearly illustrates the lack of a free market.

Farmers are prevented by privacy agreements (just one of the restrictive practices maintained within supply contracts) from disclosing their contract provisions or comparing the contracts of different processors. They are aware that different suppliers are often treated very differently by the processors, with larger suppliers often receiving a considerable premium on price. However it seems that there is also personal favouritism at work in some cases. It would be interesting for the ACCC to look at how the clawback has been imposed on different classes of farmers including Murray Goulburn directors. We encourage the ACCC to compel processors to provide their contract documentation and also to waive the privacy restrictions so farmers can disclose their own contract provisions.

Reform of supply contracts is a significant priority for dairy farmers. We note that the Australian Dairy Farmers is working with processors on development of a voluntary code of conduct that will include standard supply contracts. Farmers are not being consulted over this. Many farmers do not trust this process, and will not be satisfied unless the standard contracts are demonstrably fair to farmers, and there is a mandatory code of conduct with accessible (fast and free of cost for farmers) remedies for farmers if the code is breached by processors. Given their past performance which has led to the present problems, we would suggest that enforcement of the code should be fully funded by the processors.

Issue 2 – Contracting practices

Dairy is a volatile commodity and the ACCC understands that flexibility is built into many contracts in the industry to ensure that price changes can be accommodated. Contracts generally allow for:

- 'step ups' (price increases with a retrospective component)
- price increases (for the rest of the year – not retrospective), or
- 'step downs' (price decreases which may have a retrospective component).

Some processors also offer fixed-price contracts, although these are less common.

From 12 November 2016 a new law will protect small businesses from unfair terms in standard form contracts.[4] Many farmers are likely to be small businesses and a milk supply agreement is likely to be a standard form contract. The law aims to address some of the power imbalances existing in business-to-business transactions. Further information on these laws can be found on the ACCC's website.
Collective bargaining authorisations from the ACCC can enable producers to collectively negotiate with buyers, in circumstances where it may otherwise raise concerns under competition laws. Collective bargaining is an arrangement where two or more competitors come together to negotiate with a customer over terms, conditions and prices. This may reduce imbalances in bargaining power in commercial negotiations. Collective bargaining arrangements require the voluntary involvement of both buyers and sellers in order to be effective. Collective boycotts can also be authorised in some circumstances.

The ACCC would appreciate feedback on:

3. The different types of supply contracts used across the supply chain and in certain regions
4. Concerns about anti-competitive conduct or unfair trading practices, including unfair contract terms.

When providing feedback, you may wish to comment on:

- The use of step-ups and step-downs in processor contracts, and the use of terms that allow for retrospective payments by producers where a step-down occurs
- The allocation of risk in contracts across the supply chain
- Imbalances in bargaining power, including the level of contract negotiation
- The operation of direct arrangements between producers and retailers
- The effectiveness of existing collective bargaining arrangements and the level of awareness of and industry support for collective bargaining
- Practices surrounding the renewal of contracts, including notice periods, timing and the nature of negotiations
- Payment practices, including the timing of payments.

We note that some contracts combine fixed and fluctuating price agreements, and some farmers favour this. Preferences also vary for flat pricing or seasonal variation, with some farmers feeling that a flat price all year round enabled better forward planning and investment.

[4] A standard form contract is one that has been prepared by one party to the contract and where the other party has little or no opportunity to negotiate the terms – that is, it is offered on a 'take it or leave it' basis.

We are aware of the changes to Australian Consumer Law which may protect small businesses from unfair contracting practices. However the way these reforms have been designed excludes clear protection for dairy farmers, because of the volume of turnover and the length of their contracts. While the ACCC has previously stated that the new protections may be interpreted in farmers' favour, if there is any doubt this would obviously be contested legally by processors who have much deeper pockets to pay for lawyers than dairy farmers. Any doubt needs to be removed by further legislative reform or through a mandatory and readily enforceable code of conduct.

The current industry structure has destroyed the bargaining power of dairy farmers, and they currently incur most of the risks within the dairy supply chain. Use of step ups and step downs are a clear demonstration of this. Apart from Norco suppliers, the main example of collective bargaining appears to be through the Dairy Farmers Milk Co-operative which acts as a broker in supplying milk to National Foods (Lion). It provides a number of options in the way suppliers contract to supply milk, but its ability to negotiate on price may be limited by its ties to a single processor.

Currently most contracts have payment periods of 30-45 days. This places considerable risk on dairy farmers, as recently demonstrated by the failure of National Dairy Products to pay its suppliers. In the past it was normal practice for processors to pay farmers in 10-15 days, and this needs to be restored. As an alternative, farmers could be paid an advance bond against delayed payment.

An insurance scheme against price fluctuations and non payments may provide a solution to the unjustified risk currently borne by dairy farmers. This could be kick started by a contribution from Government but should be ultimately paid for by processors and supermarkets. Insurance payments to farmers would be made if the farm gate milk price falls below a predetermined benchmark, or if farmers don't get paid by processors or brokers who have contracted for supply.

Issue 3 – Transparency and price signals

Transparency means that key market information is available to industry participants. Improved transparency would enable those in the dairy industry to make decisions based on more accurate and reliable information.

The ACCC understand that processors have access to and use price indicators including Global Dairy Trade (GDT), New Zealand, European and US futures markets, and various data analysis and reporting services. These information sources provide price reference points for the price of various dairy products. The ACCC also understands that some producers may use these tools.

The ACCC seeks information about the accessibility, accuracy and value of price and other market information that is currently available. This includes information about the extent to which this information is used by producers and processors.

The ACCC would also like to further understand how processors set farmgate milk prices and whether this process is transparent.

The ACCC would appreciate feedback on:

5. How farmgate milk prices are set and communicated to producers

6. The availability and use of meaningful global market information and price signals across the industry, including by dairy farmers.

When providing feedback, you may wish to comment on:

- The timing and nature of processor announcements about farmgate milk prices
- The ability of farmers to compare prices and conditions offered by processors
- Other sources of pricing information that are used to assist with farm business decisions and forward planning.

Dairy farmers are often aware of global price fluctuations as measured by various monitoring mechanisms, but can clearly see there is a disconnect between global prices and what farmers are paid, which is not in the farmers' favour. Currency exchange fluctuations also need to be factored into any monitoring mechanisms, but farmers have generally seen priced reductions when the exchange rate is unfavourable but no commensurate increase in price when the exchange rate leads to increased export earnings.

We question the extent to which global indicators should determine the farm gate milk price in a situation where Australia is becoming a net importer rather than exporter of dairy products. It is noted that domestic pricing of dairy products does not fluctuate with the global dairy index, so that when farm gate milk price reductions are justified by global conditions (as occurred last year) processors actually increase their earnings from domestic retail sales.

Issue 4 – Domestic retail markets

This section of the Issues Paper is focused on understanding the impact that the practices of domestic retailers have on the dairy industry.

The impact of $1 per litre private label milk has been a key point of discussion and the ACCC will examine this issue closely through the Inquiry. A very high proportion (94%) of drinking milk (including fresh and UHT long-life) is sold into the domestic market.[5] Supermarkets account for approximately 53-54% of domestic sales of drinking milk.[6] In 2014/15, private label ('home brand') drinking milk accounted for 64% of fresh regular full cream and 51% of fresh reduced and no-fat milk sales in Australian supermarkets.[7]

However, the ACCC's assessment of domestic retail issues will not be confined to private label or supermarket sales. The ACCC wants to understand the range of domestic supply channels that are available to processors and other sellers of dairy products.

The ACCC would appreciate feedback on:

7. The major supply channels for the domestic market, including major supermarkets and other retailers
8. The impact of $1 per litre milk on the industry. This includes information about the positive and negative impacts of private label product supply contracts.

When providing feedback, you may wish to comment on:

- Any emerging supply options and the importance of production differentiation for domestic markets
- The nature and form of processor supply agreements with retailers and direct producer supply agreements with retailers
- Any links between retail agreements and shelf space or product position
- The impact of other private label dairy products (for example, private label cheese)
- Retail margins and whether retailers use milk or other dairy products as a loss leader
- Any fluctuations in prices paid by retailers to suppliers of dairy products.

We refer the ACCC to the Submission to the 2011 Senate Economic Reference Committee on "The Impact of Supermarket Price Decisions on the Dairy Industry" (recorded in Hansard), as well as claims made to that Committee by the major supermarkets which appear to have been misleading. There is clear evidence that price suppression pursued by the major supermarkets as a means of attracting customers for other products has suppressed the retail price of all milk, and has removed the ability of processors to pay a reasonable return to farmers. Claims that cheap milk would increase milk consumption have been proved wrong. It appears that processors entering into long term contracts for supply of homebrand milk have done so with virtually no profit margin unless their losses are passed on to farmers (as reported by the Financial Review and others).

Issue 5 – Global markets

While the high proportion of dairy production sold on the domestic market helps to provide a measure of stability to farmgate prices, dairy is a globally traded commodity. The Australian industry is heavily influenced by the operation of international markets, which are a major factor determining what farmers receive for their milk.

Australia is responsible for around 2 per cent of world milk production, but accounts for approximately 6 per cent of world dairy trade, ranking fourth behind New Zealand, the European Union and the United States.[8] Major export markets for Australia are south east Asia, Japan, greater China, and the Middle East, with small quantities of product going into other parts of Asia, the Americas, Africa and Europe. A range of dairy products are also imported, further exposing the industry to global markets.

Only around 7 per cent of global dairy production is traded[9], and according to data from Dairy Australia, the four major exporters produce 89 per cent of this. Thinly traded markets of this kind (ones with a limited number of interested buyers and sellers) are highly sensitive to relatively small changes in global supply or demand, as demonstrated by the recent, prolonged downturn in international prices. Despite Australia being less exposed to global markets than some other major exporters, the resulting volatility (exacerbated by foreign currency movements) impacts on the returns of manufacturers and farmers.

The ACCC would appreciate feedback on:

9. Options for supply into export markets, including products and destinations
10. Any barriers to selling into export markets.

When providing feedback, you may wish to comment on:

- The level of volatility of global market prices and the ability for exporters to manage this. This can include information about any broader impacts of oversupply in international markets.
- The use of hedging or any other risk management practices by processors
- The role of non-processor exporters in the industry (for example, brokers or companies that utilise contract packing services from processors)
- The importance of product differentiation
- The level of competition that imported products introduce to domestic markets.

As described above, this may be a non-issue. Australia has destroyed its export capacity and can no longer participate in the global market.

To some extent this has been an inevitable result of the way the Australian industry has been "deregulated" (which has actually been a virtual reregulation of the industry from within, to the disadvantage of farmers). Dairy farmers in the US, Canada and the EU receive subsidies from their governments amounting to around 50% of the cost of production. Without such subsidies, Australian farmers compete on price with countries with third world wage rates, while any labour they employ are paid the Australian minimum wage. This differential results in Australian dairy farmers operating at a loss, with many living below the poverty line (needing access to Centrelink payments to feed their families).

We suggest that the ACCC looks at the record of discussions by the Senate Committee on Rural and Regional Affairs and Transport on 3rd September 1999, examining how the dairy industry was to be deregulated. Senators were justifiably concerned that dairy farmers would be significantly disadvantaged, and felt that the peak bodies were arguing for solutions which would favour the interests of processors.

If the previous deregulation was re-examined, and appropriate checks and balances introduced to protect the interests of farmers, it would appear that Australia could compete within the global export market in the same way that New Zealand does, without subsidy. However this will require a sustained effort to rebuild the industry over the next 5-10 years. It should be noted that many of the casualties of the recent crisis have been younger farmers (who lack equity and/or have particularly high debts) and there may need to be particular incentives and assurances to attract young farmers back into the industry if it is to have a future.

Farmers are concerned that various peak bodies which have been established to look after their interests (Dairy Australia, Australian Dairy Farmers, some state bodies) have governance or financial structures which are now dominated by the interested of processors, so that they are no longer advocating for the interests of dairy farmers. We would urge the ACCC to take this into account when examining submissions from these organisations. Rebuilding the industry may require a change to dairy farmers' representative structures.

Issue 6 – Production costs and profitability

Ultimately, a strong dairy industry is reliant on the continued and profitable operation of producers. The ACCC understands that a range of factors influence the profitability of dairy farmers including farmgate milk prices, seasonal conditions and input costs such as water, feed and fertiliser.

Following a long-term downward trend in inflation adjusted farmgate milk prices, the last decade has seen a more volatile pricing environment, with the two seasons preceding 2015/16 being relative peaks. Volatile markets, combined with the erratic Australian climate and its impact on production costs, results in dairy farm cash incomes fluctuating significantly from year to year.[10] Profitability also varies between regions and farms depending on localised income, climatic and cost factors.

The ACCC also understands that many Australian dairy farms have also derived significant portions of their income from livestock sales in recent years, either of heifers for live export, or through sales of older ('chopper') cows into beef markets.

The ACCC would appreciate feedback on:

11. The key factors influencing the profitability of dairy farms, including costs of production.

When providing feedback, you may wish to comment on:

- Alternative income streams, including income from the sale of livestock. This includes information about:
  - the ability to switch between income earned from dairy and other sources
  - any barriers to supply channels for the sale of livestock.
- Any significant issues concerning the supply of inputs
- The level of competition between producers, including the factors that influence processor decisions regarding which farms they acquire milk from.

They key issue for farmer profitability is the farm gate milk price. To some extent farmers would be able to adjust their inputs and non-milk earnings around fluctuating environmental conditions to maintain profitability as long as there is a reliable floorprice which is above the average cost of production. Currently this would be broadly around 45c per litre in a situation where processors are currently paying 35-40c per litre. To make a reasonable return on investment farmers need to receive at least 50c per litre (which is coincidentally the price paid by Norco, the only remaining farmer-owned co-operative).

The current losses being made by the remaining dairy farmers are made worse by increasing levels of debt, now averaging around $1M per farm. The imposed "debts" resulting from the clawback, and other recent loan provisions, are leading to steadily increasing debt at the same time as the value of farms is decreasing, raising the risk of foreclosure by financial institutions. Debt repayments now take up a substantial portion of farmers' earnings. Any move to rebuild the industry must include provisions for reducing farm debt, possibly refinancing high interest debts to low interest loans.

Farmer Power proposes that a serious effort to save and rebuild the industry would need to include:

- requiring Murray Goulburn and Fonterra to reverse the recent clawback, paying the farmers accordingly and wiping out imposed "debts";

At the national level, the average farm cash income of dairy farms declined from around $156 000 in 2014–15 to an estimated $101 000 in 2015–16 as a result of lower farmgate milk prices and a slight reduction in milk production per farm. The projected farm cash income of dairy farms in 2015–16 is around 13 per cent below the 10-year average to 2014–15. http://data.daff.gov.au/data/warehouse/9aas/2016/adfpfd9aas20160802/AustDairyFinPerf_2013-14_2015-16_v.1.0.0.pdf

- introducing a mandatory code of conduct that removes restrictive practices and provides fairness in milk supply contracts;

- introducing measures (such as a levy on the price of drinking milk, or an insurance scheme) to establish a reliable floorprice in the farm gate price of milk;

- removing the imposed "tax" on farmers to pay for the major part of Dairy Australia's operations, and converting the compulsory levy to a voluntary subscription;

- restructuring farmers' representative bodies to remove conflicts of interest and improve farmers' capacity for collective bargaining;

- providing easy access to low interest loans that enable dairy farmers to consolidate their debts and reduce interest repayments, as well as encouraging new farmers to enter the industry.

While these measures will assist dairy farmers, there may need to be additional measures that provide dairy processors with more rights in negotiating a fair retail price for their products with the major supermarkets.

We note that when the dairy industry was deregulated in 2000, dairy farmers were promised that the impacts of the deregulation would be reviewed and appropriate adjustments made. This has not happened despite the compelling evidence that the way the industry has been deregulated has not worked. We urge that the ACCC Inquiry should include such a review, with a reconfiguration of the checks and balances needed to protect the productive potential of farmers in the interests of the industry as a whole.