Queensland Dairyfarmers' Organisation Limited ABN: 90 090 629 066

Mr Mark Fitt
Committee secretary
Senate Economics References Committee
Department of the Senate
PO Box 6100
Parliament House, CANBERRA ACT 2600
Email: economics.sen@aph.gov.au

12th October 2016

Dear Mr Fitt,

Re: Inquiry into the Australian dairy industry

The Queensland Dairyfarmers' Organisation Ltd (QDO) welcomes the opportunity to provide to the Senate Economics References Committee with this submission. The QDO is the peak industry organisation representing the interests of dairy farmers in Queensland. The QDO is a member of the Australian Dairy Farmers (ADF) and the Queensland Farmers' Federation (QFF).

The original motion by Senator Lambie amongst other things stated that, "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…..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….That the above matters be referred to the Economics References Committee for inquiry and 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."

It is clear from the motion that the inquiry needs to deal with a range of issues related to the dairy industry including retail milk pricing, processor contracts, finding a long term solution to the Australian dairy crisis and any other related matters. The resolution of the Senate establishing this inquiry makes clear the general issue of milk pricing is before the inquiry.

The QDO submission will focus on retail milk pricing which is at the heart of the Australian dairy crisis and needs to be solved once and for all if the dairy industry is to have a long term future. We seek adoption of recommendations that will establish a fair, long term solution to Australia's dairy crisis by solving the current problem of retail milk pricing.

The single national milk pricing policy of major retailers – whatever its purpose or intent – directly causes unfair and unreasonable business conditions for dairy farmers in Queensland. The Queensland dairy industry is completely dependent on the domestic market. In 2015/16, 407ML of milk was produced in Queensland while around 585ML was consumed as milk (fresh white, UHT and flavoured). All milk produced in Queensland is consumed in Queensland and around 178ML

(30%) of milk consumed is trucked in from southern states (Victoria and NSW). In addition, around 55% of white milk sold is retail brands, which average $1.01/L according to Dairy Australia figures, while 45% is branded fresh white milk.

UHT production has moved to other states as has the majority of the high margin flavoured milk. Lion has recently moved 15ML of flavoured milk production from Queensland to Sydney. This means that the Queensland dairy industry is completely dependent on the domestic market and that retail fresh white milk pricing, including $1/L sales, determine the price paid to farmers.

Coles introduced $1/L milk in 2011 while in 2010 store brand milk was selling for on average $1.17/L. when taking into account inflation between 2016 and 2011, $1 in 2016 is equivalent to 85c in 2011. If we go forward another 5 years, $1 in 2021 will likely be around 70c in 2011 dollars when you take account of inflation. When we compare the $1.17 that was received in 2010 to the 70 c in 2021 (in 2011 dollars) this would effectively be a 40% reduction in price in 11 years. It is unclear how any business in Australia could cope with such a massive cut to their price. However as price takers, completely exposed to the domestic market and the desires of the price setting retailers, dairy farmers in Queensland are expected to put up and shut up in the interests of retailer's profits and consumers getting milk at a price which is below sustainable levels.

Debates about whether retail prices provide sustainable prices at the farm gate are often based around trivial, self-interested and misguided debates. In 2010 before $1/L milk was introduced there were 621 dairy farmers in Queensland while today there are 429.

Milk production in Queensland fell steadily after deregulation from 848ML in 1999/2000 to 537ML in 2006/7. Between 2006/7 and 2009/10 milk production was very stable and Queensland production roughly met Queensland consumption. In 2010 milk production was 530ML. However since the introduction of $1/L in early 2011 milk production in Queensland started falling again. In 2015/16 Queensland milk production had fallen to 407ML.

According to Dairy Australia, farm gate prices in Queensland were 57.2c/L in 2008/9. This fell to 53.1c/L in 2010/11 when $1/L milk was introduced. The price has recovered to 57.4c/L in 2014/15 and the price would have been similar in 2015/16. So in reality the price has stayed the same since 2008/9 due to the imposition of $1/L milk. This is despite 7 years of inflation which amounts to a 19% inflationary impact during this time. So in reality farm gate prices have fallen by 19% in real terms since 2008.

In 2015/16, 66% of Australia's total 9.7 billion litres milk production went into the domestic market. That is, 6.3 billion litres were consumed domestically and 3.4 billion litres were exported. If the Australian production drops by 7% as predicted, the domestic share will be about 72%. In the late nineties by comparison 65% of Australia's 12 billion litres total milk production was exported. Our population is increasing by 350-400,000 per year, so an extra 110 million litres or about 1.5% growth is needed every year for the domestic market.

It is clear from the movement in farm numbers, milk production and a fall in real farm gate prices that the pricing levels imposed from lower retail prices has had a devastating effect on Queensland dairy farmers.

It is clear that the current use of milk as a close to or below cost 'advertising agent' by major supermarkets is having a direct cumulative and detrimental impact of the domestic fresh milk dairy industry. It is progressively undermining the viability and sustainability of the domestic dairy industry.

It has often been claimed by retailers that dropping the retail price of milk will cause the consumption of milk to increase. However studies by Dairy Australia clearly show that this is not the case. Despite initial rises, the per capita consumption of white milk is no higher in 2016 than in 2011 when the discount retailer brand milk was introduced. In effect by retailers reducing the retail price of milk margins have been wiped from the value chain but there has not been any volume response from consumers. This is a lose lose situation for dairy farmers. And given that farm gate prices have been stagnant, and fallen considerably in real terms, it is hard to credibly argue that retailers have worn the cost of the reduction in margins when clearly farmers have borne the brunt of the reductions.

With this evidence it is clear that the current practices of supermarkets needs to be addressed to ensure the future viability and sustainability of the domestic fresh milk dairy industry, which is in the interests of all in the industry supply chain, including the major supermarkets, all levels of Government and most importantly Australian consumers.

It is short sighted to believe that forcing retail milk prices down is in the interests of consumers. In the short term, consumers do benefit from lower milk prices. In the longer term though, as retailers wipe out other retailers and milk brands, consumers will pay for the lack of competition. Retailers will gain greater control of the retail market, as has occurred for the majority of the last 5 years, and consumers will eventually pay more due to this lack of competition. And at the same time dairy farmers will not be making a reasonable profit and substantial damage will occur to the dairy industry as has occurred over the last 5 years.

The introduction of regional cost reflection pricing is critical to the future of the dairy industry but also to fair competition by retailers and milk processors. Postage stamp pricing prohibits competition by allowing retailers to cross subsidise between different regions and stop other retailers and processors from competing in higher cost markets including Queensland.

While some retailers sell their branded product on the shelf for $1/L throughout the country the cost of delivering that product to their stores appears to vary considerably. Anecdotal evidence suggests that in some regions the cost to get milk to stores is around 73c/L if not lower, some like Queensland are very close to $1/L while other markets are reportedly $1.25/L. These costs of supply do not include a reasonable apportionment of retailer costs or a profit margin for retailers.

Is it anti-competitive to allow retailers to sell milk for a $1/L if the cost of acquiring this milk is more than that? Clearly it is impossible for other retailers and processors to compete for retail market share if their main competitor is willing to sell at a loss by cross subsidising between regions to acquire market share. Smaller retailers are unable to compete in this distorted market place and have no choice to lose market share. It is also impossible for processors to compete into these high costs markets unless they are willing to lose money to do so. Processors are only selling dairy products, mostly milk, and are not able to cross subsidise profits from one product to make up for losses on others as the major retailers do.

So clearly it is anti-competitive for major retailers to sell milk below the cost of delivering that milk and thus must be prohibited by government. Retail prices of fresh white milk should reflect the cost of selling the milk in each region that it is sold to allow dairy farmers, all retailers and all milk brands to compete on a level playing field.

In addition retailers apply different cost allocations methodologies and margins for different products they sell. For their own milk brands they sell, the allocation of retail costs and margins is often low or zero to make these products attractive to consumers and to gain market share. For processor branded milk, there are usually a higher allocation of retail costs and significant retail margins, reported to be between 24 and 40%, which makes the price of branded milk higher and less attractive to the consumer. This predatory pricing practice is anti-competitive and should be prohibited by government.

QDO's has ongoing concerns with the deficiencies within the provisions of the competition laws. Australia is one of only two countries that doesn't have an 'effects test' in their respective competition laws. The 'Effects Test' looks at what the 'effect' of the action is on competition to determine if it reduced competition. The proposed amendment would mean corporations with large market power could not carry out actions that have the intent, effect or likely effect of reducing competition.

It is clear to all rational people that an 'Effects Test' would be a positive for competition and deliver better market function. In an Australia without an 'Effects Test' large powerful companies can unfairly damage suppliers and small competitors and our ACCC cannot prove anti-competitive intent or 'purpose' even though the 'effect' is clear. After all, the objective of the Competition and Consumer Act is the promotion of competition, fair trading and consumer protection. It would be advantageous for it to do what it was intended to do.

There have been a long list of breaches of the current competition law by major supermarkets over recent years and the list would have been much shorter with laws that actually worked to support farmers. Competition law reform remains essential for all of our futures in small business, farming and as consumers. The fact that Britain, which was the training ground for most of the architects of milk discounting in Australia, has had to strengthen their competition laws to control the excesses of retailers should not be ignored.

A commitment by the federal government to introduce of an 'effects test' into the Competition and Consumer Act must be delivered upon. This was a change called for by the Harper review of Competition and Consumer Law. The senate enquiry also needs to ensure that an 'effects test' is introduced in Australia to address anti-competitive practices of some big corporates, not only for dairy but for all Australian businesses. It is vital for all Australian dairy farmers and all small businesses that the changes to section 46 of the Competition and Consumer Act proposed are implemented by both sides of politics and supported by Dairy Senate enquiry.

This is not a dry economic debate, this is a real life disaster for farmers who are small business operators who are caused personal and business harm as a result of milk pricing policies they cannot influence. But it is not only dairy farmers who are affected. The resultant closure of processing facilities has had dire consequences for the workers in those processing facilities. The small businesses that service dairy farms and processing facilities have been badly affected. Also the regional communities that depend on dairy farmers and processing facilities for their livelihoods have been adversely affected.

All the dairy farmers of Queensland understand the impact that retail pricing has had on their business and that removing $1/L is the most important issue facing their businesses. In a recent QDO survey of our members in August 2016, 72% of our members stated that finding a solution to the low milk price was a high priority for their business and QDO. To put that in context, the issue which was seen as second most important had support from only 15% of dairy farmers. This highlights that finding a solution to the low milk price is by far the most important issue for dairy farmers in Queensland and is by far the biggest issue affecting the profitability and viability of dairy farms in Queensland.

The QDO asks the members of the Senate Economics References Committee to carefully consider the medium to long term implications if the current practices of major supermarkets using fresh milk as a, near or below cost, marketing agent are allowed to continue. These implications are for dairy farmers, processors, vendors, small retailers and employees involved in the fresh milk industry supply chain and to choice and prices to consumers.

I ask for the Senate Committee to sit in rural Queensland locations and hear from witnesses (actual past and present dairy farmers) to hear real stories of the impact that retailer pricing decisions have had on them. You will then hear first hand the direct real impact retail pricing decisions have had on Queensland dairy farmers.

In summary, the QDO highlights that:

- Dollar a litre pricing for supermarket white milk is the principle determinant of dairy industry viability in Queensland. Farm gate prices for milk are principally determined, via the supply chain, by dollar a litre pricing;
- Because of dollar a litre pricing, farm gate prices in Queensland are below farm subsistence levels – they do not allow the necessary and normal range of business expenses to be incurred:
    - The expenses avoided by hard-pressed dairy farmers are, of necessity, those which are optional today, but are not optional if an individual property or the industry is to have a future.
    - Those avoided expenses include equipment to make production more efficient, equipment to reduce reliance on grid power, implementing new innovations and training;
- Failure to abandon dollar a litre pricing deprives the industry in Queensland of its future;
- Failure by the Senate and the Parliament to intervene urgently and with effect in this pricing structure is an implicit but perfectly clear and unambiguous demand that the dairy industry in Queensland die;
- This is not a dry economic debate, this is a real life disaster for small business operators who are caused personal and business harm as a result of milk pricing policies they cannot influence;
- We seek adoption of recommendations that will establish a fair, long term solution to Australia's dairy crisis.

We seek the following findings and recommendations from this inquiry and from the Senate:

- Milk pricing policies in Australia are causing hardship resulting in otherwise, sustainable dairy farmers being forced to exit the industry often at significant personal financial costs to their families and to their physical and mental health, and the consequent harm to local communities;

- The hardship caused by milk pricing policies arises from the market power of those setting those policies;
- Pricing milk below cost in Queensland and other locations has the effect of unfairly and inappropriately excluding proper competition and manipulating the market, as well as causing hardship;
- The hardship experienced by dairy farmers have flow on effects to the economic well-being and sustainability of rural communities;
- An effects test be introduced;
- Retail prices of fresh white milk should reflect the cost of selling the milk in each region that it is sold to allow dairy farmers, all retailers and all milk brands to compete on a level playing field;
- Allowing retailers to sell milk under the cost of acquiring that milk without an equitable allocation of costs and a reasonable profit is anti competition and should be stopped;
- If those who set farm-gate prices by setting wholesale and retail prices will not self-regulate immediately to resolve this serious long-understood problem, then Governments at every level in Australia should immediately take every legal, every legislative, every enforcement, and every moral suasion action open to them, to resolve the problem on a regional level.

The QDO appeals to you and your committee members to adopt our recommendations and to work with our industry to implement these recommendations as a matter of urgency.

I have attached the three QDO submissions from the previous senate dairy enquiry in 2011 for your information. The QDO stands ready to provide any further information, where possible, Committee members may require and would welcome the opportunity to discuss any of the information presented.

Yours Sincerely,

Brian Tessmann
President
Queensland Dairyfarmers' Organisation Ltd