

Performance of Australia's Dairy Industry and the Profitability of Australian Dairy Farmers Since Deregulation in 2000: Experience of the WA Dairy Industry *Submission from WAFarmers Dairy Council*

WAFarmers Dairy Council

The Western Australian Farmers Federation (Inc) (WAFarmers) is the main agricultural advocacy group in Western Australia (WA). It represents the voice of farmers throughout our state. The WAFarmers Dairy Council is the peak advocacy group for the dairy industry in WA. We aim to supply our consumers with safe, wholesome and nutritious dairy products. We aim to ensure the dairy industry is sustainable: profitable for farmers; safe for the environment and our animals; and valued by the community. The Dairy Council works in the policy field to ensure our industry is involved in shaping the regulations and laws under which dairy businesses operate. We contribute to strong leadership and nationally coordinated policy and advocacy work so the dairy industry can continue to grow and prosper. WAFarmers Dairy Council is well represented by its peak national body Australian Dairy Farmers and has very active representation on the ADF Policy Advisory Groups.

WA Dairy Industry

The WA dairy industry is generally in a less strong position than the eastern states' dairy industry which has more consumers and greater product diversity and growth opportunity due to investment in diverse manufacturing. The large majority of the WA dairy product is fresh white milk.

WA has a population of only 2.7 million. The state and its dairy industry are among the most isolated in the world, with a tightly defined milk market. In 2018/19 it supplied 374m L fresh white milk to the WA domestic market, worth \$187.8 m.

As with elsewhere in Australia, WA suffers from an oligopoly of three main supermarkets. WA also has only three main processors.

Scope of the Inquiry

We think the scope of the inquiry is too broad, and it confuses the issue of Dairy Australia's performance with the impacts of deregulation. Dairy Australia (DA) does not drive profitability in the industry, although it supports profitability through R,D&E. DA's performance is being examined in other inquiries. WAFarmers Dairy Council believes DA does a reasonable job and we have no major concerns about it. However, we make a few brief comments below in relation to the terms of reference.

Performance and Profitability of the WA Dairy Industry Since Deregulation

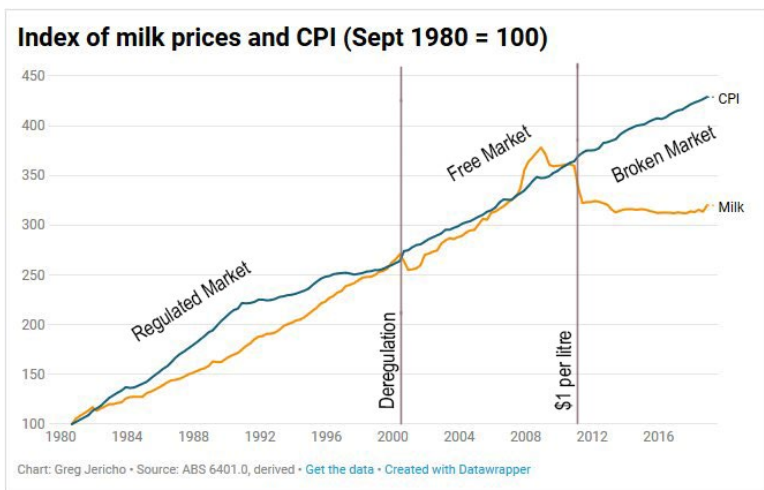
Below we identify the impacts of deregulation on the WA dairy industry then we address the Terms of Reference directly.

Milk price decline

One important impact of deregulation was the decline in average farmgate milk prices, particularly in WA. There were various impacts on individual farmers depending on their reliance on market milk. Initially after deregulation the market power shifted to the processors and retailers. However, it soon became evident that the true power lay in the hands of the supermarkets when they introduced \$1/L milk. Deregulation enabled the supermarkets to introduce \$1/L milk and it was this

event that broke the market. When the supermarkets introduced \$1/L milk, they chose to have a reduced margin as a loss-leading marketing strategy. The problem is that \$1/L milk limits the capacity for value in the rest of the supply chain. As well as harming farmers, milk discounting harms as processors who get squeezed for shelf space, if they do not comply. In this way, \$1/L milk reduced the value of all market milk sold, including branded milk.

Retailers argued that milk is a commodity which is equivalent across time and place, but this is incorrect as milk production costs vary depending on when and how we produce it. Milk is not a commodity but a fresh perishable product that has to be picked up every day and processed before



it is sold. Dairy farmers have to produce a certain amount of milk every day to supply the domestic market. This all comes at a higher cost than producing milk seasonally for the global commodity market.

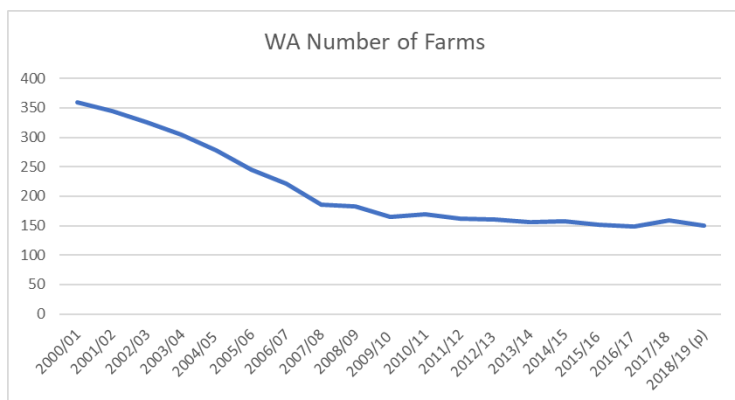
Costs of production have also gone up. In the last couple of years our largest costs, i.e., feed, have gone up over 25%. A domestic market should have the ability to respond through the

supply chain to reflect this cost, as would happen in other industries. This has not happened. Although milk prices have up-ticked slightly this year since the end of \$/L milk, very little of the increase has gone back to the farmgate. The fresh milk market remains fundamentally broken.

WA dairy farmers' negotiating ability is very limited because of the nature of fresh white milk. The retailers' argument that milk is a commodity that is equivalent over time and place was abused by themselves to increase their power in the market place.

Deregulation focused on the supply side of the market which shifted power in favour of the retailers, and no measures have addressed this problem since. The result in WA has been that dairy farmers have had to operate on wafer thin margins or exit the industry.

Scale of WA dairy industry



The large number of dairy farmers exiting the WA industry has been another casualty of deregulation. The graph shows the decline in the number of WA dairy farms since regulation.¹ The overall number of cows in WA has declined from 72000 to 56000 since deregulation.² Milk production has also declined from a high of 404 ML to 374 ML.³ These figures point to a decline in

¹ Data source: Dairy Australia

² Dairy Australia

the scale of the WA dairy industry.

At the same time, however, the number of cows per farm and litres of milk per cow have both increased, resulting in increased productivity per farm. Before and after deregulation farmers have continued to be more efficient and will continue to do so, but the supply chain must be able to guarantee the ongoing supply of fresh milk in all regions.

WA dairy farmers now live off the demise of others. This makes the WA industry increasingly vulnerable to market manipulation and shocks. If the trend continues it will be hard to maintain a dairy industry that can support food security for WA and the ongoing availability of fresh, wholesome, local milk on our shelves. We are down to 140 dairy farmers and presently there are 11 herds on the market. We are getting close to the point where we have insufficient critical mass for service providers to be able to meet our industry needs.

Loss of rural land and employment opportunities

As dairy farmers exit the industry, land is lost to dairy farming and it goes instead to alternative lifestyle blocks or beef farming. Once land is lost to dairy it is hard to return it to dairy. It is a big investment to set up a dairy, and our farmers operate at low margins.

In addition to losing land, a declining dairy industry means a loss of employment opportunities. Dairy farming is very intensive and requires skilled labour. A dairy with a herd of 700 cows typically employs six families, compared to a beef farm with 700 head which would employ only the owner-operator family.

Manufacturing decline

A related impact of deregulation of the supply side of the dairy industry was the collapse of the manufacturing industry in WA. The WA market is different from Victoria which has not suffered as badly as WA. Victoria remains a dairy manufacturing state while WA has now lost nearly all our manufacturing growth and diversity since deregulation. This was an unintended casualty which has caused our industry to shrink, when deregulation was meant to improve the industry.

Without a manufacturing base, WA dairy farmers now rely solely on the production of fresh white milk for the domestic market. Almost all butter, cheese and powdered milk is imported into WA now. Given our remoteness, this importation increases the 'food miles' that all these manufactured products have to travel. This outcome does not pass the sustainability test in terms of economic efficiency, environmental impact and consumer choice.

Prior to deregulation there were reasonable margins that allowed for cross subsidisation between the manufacturing and daily milk sectors. This enabled investment in manufacturing and balancing of seasonal overs and unders. WA now has an issue with balancing our seasonal milk supply and demand. We have also lost growth, diversity and export opportunity.

Profitability

Since deregulation, there hasn't been a mechanism to get value back to the farm gate. The processing sector has also lost its profit margins on fresh white milk. Although Dairy Australia data show reasonable profit margins for WA, these are misleading as they represent the top 25% of dairy farmers only. These data also exclude all the farmers who have had to leave the industry.

Terms of Reference

³ Dairy Australia

a) the ability of Dairy Australia to act independently and support the best interests of both farmers and processors;

- DA has acted on behalf of the processors in relation to marketing, export and social licence despite the fact that processors have not contributed any levies.

b) the accuracy of statistical data collected by Dairy Australia and the Australian Bureau of Statistics;

- DA surveyed only a small percentage of Australian dairy farms in their recent survey of dairy farm performance programs (DFPP); this small sample was biased in favour of high performing farms who target continual improvement. A larger more representative sample is required in future DA DFPP surveys.

c) the funding of Dairy Australia and the extent of its consultation and engagement on the expenditure of levies revenue;

- Australian Dairy Farmers and state-based advocacy organisations should be able to access the unmatched levies paid by dairy farmers to ensure dairy farmers' interests are properly represented.

d) the merits of tasking the ACCC to investigate how it can regulate the price of milk per litre paid by processors to dairy farmers to ensure a viable dairy industry;

- ACCC is not an appropriate organisation to investigate the regulation of the price of milk per litre paid by processors to dairy farmers.
- The role of the ACCC is to look after the consumer and consequently they have supported \$1/L milk which has seriously impacted the dairy industry in WA.
- Cheapest milk for consumers is not necessarily best for the dairy industry. Value, choice and guaranteed supply are also important.
- Investigations into regulating the price of milk should instead be made by an independent body with strong representation from dairy farmers who understand their needs in relation to a strong dairy industry and food security.
- The ACCC should instead be focusing their investigations on the issues around the anti-competitive oligopoly of supermarkets.

e) alternative approaches to supporting a viable dairy sector;

- Deregulation has focused on the supply side and this has not worked for the WA dairy industry: both the processors and farmers have lost the ability to extract a profit margin, while the supermarkets have benefitted. It is important that the entire dairy industry chain is able to make a reasonable profit.
- One way of strengthening the competitiveness and resilience of the industry in the long term is to introduce a strategic retail levy. This levy would be applied at the point of retail and the proceeds would be returned directly to the dairy farmers.
- The aim of a strategic retail levy is to support the dairy farmers; ensure food security with fresh, wholesome, local milk on the shelves; and support the growth of an export market on top of a stronger domestic market. On a national basis, our milk will have a home and the export industry will benefit from domestic support. The levy should be extracted on a state by state basis. In WA, some of the levies could go towards building infrastructure through a new generation cooperative in order to bring back manufacturing growth and export opportunities. This would be good for the farm base and for the state's industry at large.

- The strategic intervention of a retail levy or a similar mechanism would be required for a few years until the oligopoly in the retail sector is corrected and the dairy industry is on a stronger footing.

f) the introduction of a mandatory industry code of practice;

- An effective mandatory Code of Conduct should redress the power imbalance in the market place between processors and farmers. It should make the terms and conditions more favourable for dairy farmers but will not extract value from the market place for farmers. The WAFarmers' Dairy Council has made a submission to the Code of Conduct inquiry and also supports the Australian Dairy Farmers' submission.
- The Code should support farmers where they have a long-term contracting relationship with a processor, the current agreement is due to end and the farmer is unable to source a new agreement, through extending the milk supply agreement for 12 months. This is to support the farmer to manage the transition of their business.
- In any case, and regardless of how long term a contract is, we believe there needs to be an ethical agreement signed by processors acknowledging that they are jointly responsible for the milk production system of which they are a part. They need to recognise that it would take 12 months for a dairy farmer to manage an exit from the industry because the farmer has to resolve his business, sell assets, and address animal welfare and environmental concerns. This ethical agreement needs to be signed off by large processors (exempting small business) as an overarching understanding of the production system they are involved in.

g) any related matters.

- While productivity and efficiency are important aspects of a healthy industry, there are also big picture strategic considerations that deregulation does not necessarily address. These are food security and resilience of the industry.
- **Food security** is a significant issue for Western Australia; no less so than homeland security. It is important to be able to feed our own population, and fresh white milk is a basic component of a healthy diet. A reliance on imported UHT or ESL milk from the eastern states or New Zealand would erode our ability to be self-sufficient in the basics of food supply.
- **Resilience of the dairy industry** is another significant issue. A highly streamlined efficient industry can lead to low diversity in farm size and system, and this can make it vulnerable to collapse if it is allowed to fall below critical mass.

Conclusions and Recommendations

1. Dairy Australia does a reasonable job in supporting profitability in R, D&E. A portion of their unmatched levies should be allocated to national and state advocacy organisations. Their DFPP survey should be larger and less biased towards high performing farms.
2. The ACCC is not an appropriate organisation to investigate milk price regulation as their interests lie with cheapest prices for the consumer. They should focus their efforts on improving the competitiveness of the supermarket sector. Milk price regulation should be investigated by an independent body with strong representation from dairy farmers who understand their needs in relation to a strong dairy industry and food security.
3. By focusing on the supply side of the market, deregulation has seriously impacted on the long term viability of all aspects of the dairy industry in WA. The long term solution lies with developing demand-side strategies that address the oligopoly of the retailers. The short term solution lies with a temporary retail levy administered on a state by state basis with proceeds going back to farmers, and potentially in WA into rebuilding a cooperative.

4. An effective mandatory industry Code of Conduct should improve terms and conditions for dairy farmers but will not extract value from the market place for farmers. Therefore it needs to be complemented with Recommendations 2 and 3 above.
5. Productivity and efficiency are important but food security and industry resilience are also an important part of the bigger picture.
6. In the last 10 years the dairy industry has had 10 reviews. Findings need to be implemented for the dairy industry to improve.
7. In many countries with mature dairy industries there is domestic support for the dairy industry. Is Australia losing out as a whole due to the lack of such strategies?

WAFarmers Dairy Council, December 2019.

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