Farmer Power

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SUBMISSION TO THE SENATE ECONOMIC REFERENCES COMMITTEE FOR ITS INQUIRY INTO THE AUSTRALIAN DAIRY INDUSTRY

Background

This submission is made on behalf of Farmer Power, which is a voluntary association formed in 2013 to advocate for the interests of Australian dairy farmers. It is tabled by Alex Robertson as Vice President of Farmer Power, who is able to appear before the Committee. Our members are farmers who are concerned about the deteriorating state of the dairy industry, and the lack of action to address the industry's problems.

There have been assertions that Farmer Power wants to reverse the deregulation of the dairy industry that occurred 5 years ago. This is not the case. We are concerned that the deregulation process that has occurred has been corrupted, so that dairy farmers are in fact regulated more than ever, while dairy processors are free to exploit farmers in ways that can only be described as feudal.

The crisis that hit dairy farmers in May this year was not the start of the crisis. As Minister Barnaby Joyce well knows, it goes back several years when the industry was falling on its knees. In 2014 he attended a meeting of around 600 dairy farmers in Tongala where he heard from individual farmers about the ruinous state of the industry, and he promised urgent action then (see photograph below, Barnaby Joyce seated). However we have not seen any real action by the Government to rebuild dairy production in the national interest.

State of the Industry

The decline of the industry in the last 15 years is evident from statistical data. Before deregulation farmers received 53c per litre at the farmgate and milk retailed for $1.21 per litre. Australia had 13,500 dairy farmers. Total milk production was 11.2B litres and 80% was directed into export products. New Zealand had a similar scale of dairy production.

Now, 15 years later, farmers receive 30% less at the farmgate, there are only around 5,500 farmers left, production has fallen by 30% (taking account of the latest falls) and in the same time New Zealand has doubled its dairy production. We are on trend to become a net importer of milk by 2018. This is despite the fact that the quality of Australian milk is heralded as among the best in the world (being derived from pasture fed cows, which attracts a premium in some overseas markets), and dairy products could be one of our major export industries.

The reduction in milk price and the clawback made by processors Murray Goulburn and Fonterra in May this years (which was followed by price reductions amongst other processors) has been the last straw for many dairy farmers. Dairy Australia's latest Situation and Outlook Report identifies a 10% reduction in milk supply over the year to August, with most of this occurring since May as farmers culled their herds and quit the industry. That was four months after the latest price drop and clawback, and the decline in production has continued since then. If it has continued on trend (which is more than likely because of recent flooding exacerbating the situation) the current year-on-year drop would be around 12-14% nationally. When the winter incentive payments cease next month, we can expect the next wave of farm closures.

Reports from saleyards suggest that the majority of cattle sales (from farmers quitting the industry) have been generated by previous suppliers of Murray Goulburn and Fonterra, the processors who provoked the recent crisis. Many suppliers to MG and Fonterra have sought contracts with other processors, with some being knocked back. The decline in the milk supply to MG and Fonterra is already having a significant impact on their own production. Dairy farmers have family and friends working in the processing plants, who report some production lines being closed, and workers fearing for their jobs.

The processors, government spokespeople and industry peak bodies have tended to blame the situation on the global dairy price. This is not substantiated by the facts. The Dairy Australia report identifies a 20% increase in global dairy prices over the past year. However it is questionable how much impact global prices should have in Australia, given domestic sales now account for around 75% of the market, trending upwards.

If proof was needed that Australian farmers are underpaid by the processors, see the tally of milk prices paid to farmers by the major global processors in the international Dairy Reporter. Murray Goulburn does not feature (too small) but Fonterra is on the list, and we know that these two companies keep in step. Fonterra is right at the bottom of the table, paying farmers less than half that paid by the most generous suppliers. The report notes the recent and projected global price trend upwards.

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=

The Dairy Australia report highlights what consumers have done to help the industry, with name branded milk increasing its market share by 7% so that it is now the major component of drinking milk sales. DA admits that this is "*putting more value into the supply chain*", but it falls short of saying by how much, and even more importantly where this being directed within the supply chain. As the industry body funded largely by dairy farmers to look after their interests, we would ask why these important facts have not been reported. We think it must amount to around $70M extra in the supply chain from which the benefits are being shared between the supermarkets and the processors, with little if any flowing on to the farmers.

So if global dairy prices have increased by 20%, and returns from domestic dairy sales increased (not only because of the shift to name brand product but also as prices were largely negotiated before the recent farmgate price crash), why are farmgate prices 20% lower than they were last year? Does that mean there is 40% extra in the supply chain? No it doesn't, because the processors actually squandered the extra industry profits by investing in large expensive dryers and then found there was no market for milk powder. Warehouses around Victoria are stuffed full with this stuff. Having made this catastrophic mistake the processors decided to pass on all their losses to the farmers.

The processors appear to have fooled themselves into thinking they could get away with this without any impact on milk supply, and of course they were wrong. The reduction in supply now threatens their own viability, especially given their previous huge capital commitments to expand plant capacity, based on Dairy Australia's overoptimistic past reporting that milk supply will steadily expand.

The whole industry is now at a tipping point. Does the Government want a viable Australian dairy industry with export potential, or does it see the future as one in which Australia imports its dairy produce from New Zealand? All signs at present point to the latter.

Welfare is Not the Answer

The only response from governments has been to offer concessional loans and welfare access to farmers. In practice these are not accessible to most dairy farmers, with numerous obstacles preventing them from getting the help they need. We can expand on these difficulties, but they have been well reported in the media.

This is not the focus of this submission because offering this type of assistance is not the answer that the industry needs. Farm debt is already at unsustainable levels, having increased over the past few years as the dairy crisis has deepened. Welfare payments, while putting bread on the table for many farmers, will not stretch to providing feed for cows or rebuilding herds.

What Went Wrong?

Deregulation of the dairy industry was introduced in 1999-2000 specifically to enable Bonlac and Murray Goulburn to be able to produce export product at more competitive price, ie to grow Australia's exports by reducing returns to farmers. At that time these two companies controlled 50% of the milk supply in Victoria, and Victoria produced 64% of the nation's milk supply. Bonlac collapsed soon afterwards and was taken over by New Zealand company Fonterra. The push for deregulation was resisted by some other State Governments and State industry bodies.

The deliberations of the Senate Standing Committee on Rural and Regional Affair and Transport on 3rd September 1999 reveal the way that things were rushed through without due consideration of the impact on dairy farmers.

Those with a farming background warned the Committee that the projected price drop to around 39 cents a litre would mean that a typical farm would face an immediate loss of around $4,000 per month, the capital value of all farms would fall, the banks would be concerned at the loss of security, and the industry would be thrown into chaos. This would not enable the growth of exports.

It was pointed out that farmers need a three year time horizon to plan for future milk production, but they only need a timeframe of one second to decide to send a cow to the abattoir.

It was foreseen that whereas a rational approach to long term planning would see the processors keen to pay farmers a sustainable price for their milk, the prevalent behaviour amongst both processors and supermarkets appeared to be driven by power and greed. It was estimated that around 25% of farmers would be put out of business, though the Committee was concerned that there had been no rigorous assessment of the total impact on farmers and the social fabric of regional communities in which they were located.

The Senators expressed considerable surprise that the industry bodies (United Dairyfamers of Victoria and the Australian Dairy Farmers) were unequivocally supporting the State Government view rather than standing up for the farmers who would be disadvantaged. This prompted one Senator to remark that "*I will not be responsible for signing the death warrant of so many farmers without questioning the body that is meant to represent them.*" The Committee identified significant conflicts of interest because of the involvement of processors in these bodies.

The Committee considered options for softening the impact on farmers, and noted that other exporting countries applied a range of measures to support farmers which did not conflict with free trade agreements. This resulted in an average $565 per acre subsidy in Europe, $70 in the US, compared with around $2.50 in Australia. It was pointed out that the World Trade Authority's guidelines were treated as rules by Australia, but as guidelines by its competitors.

The result of the Committee's deliberations was the introduction of the dairy levy that provided a supplement to the farmgate milk price, together with a range of other temporary measures. The dairy levy was collected on all drinking milk through Dairy Australia and redistributed to all farmers as a price supplement. This worked reasonably well in softening the impact of fluctuating milk prices, but it was removed in 2008.

In 2010 things worsened as Coles introduced $1 a litre milk. This prompted action by the ACCC and the Government, with Coles being forced to defend their strategy. The price reduction was followed by Coles' competitors, and it also pulled down the price of name brand milk, stripping over $200M out of the milk profit pool. More recent assessments of homebrand milk contracts have indicated that processors make negligible profits from supplying milk at this price, and of course farmers are at the bottom of the supply chain receiving less than the cost of production.

We congratulate the Financial Review for its investigative journalism leading to its article on June 13 this year about Dairy Australia's misleading commentary on the domestic milk market. The 2016 Situation and Outlook report attempted to prove that $1 a litre milk was good for the industry while its own statistics prove otherwise. In fact, over the past five years $717M of revenue appears to have been lost to the value chain - a loss passed on to farmers. The profit margin for the processors from homebrand milk has been estimated as around 1%. With so much product being sold at virtual break-even, this clearly impacts on the farmgate milk price, as processors rely on their dwindling volume of other product streams to derive a profit.

In 2011 the Government was informed about the impact of homebrand milk on farmers' incomes, and the threat to the dairy industry as a whole. These recommendations were made by the Australian Dairy Industry Council which is an industry representative peak body. The ADIC also expressed concerns about farmers' lack of collective bargaining power over milk supply contracts with processors. The Government appears to have completely ignored the recommendations of this report. Five years later Minister Barnaby Joyce has publicly acknowledged the damaging effect that $1 a litre milk has on the industry, and has said it should be stopped, but there is still no action.

The other damaging factor since deregulation has been the way in which farmers have been effectively re-regulated by the industry, subjected to increasing control over their ability to earn a living. People outside the industry have been surprised about the clawback provisions in milk supply contracts recently implemented by Murray-Goulburn and Fonterra Australia. However this is not the only feature of milk supply contracts that are unfair to farmers. Here are some of the other restrictions on farmers that robs them of their collective bargaining ability.

1. Many contracts have secrecy provisions which are designed to stop farmers finding out if they could get a better price elsewhere, or in some cases find out if neighbouring farmers are getting paid much more by the same processor.

2. Many contracts have “loyalty” provisions which are actually a mechanism for withholding payments, and if the farmer switches supplies these payments are never made. Effectively it prevents farmers getting paid the full price for their milk unless they stick with the same supplier.

3. There is no fixed price or price formula within the contracts for providing milk. There are obligations on the farmer for supplying at guaranteed quality and quality but no guarantees the other way around.

4. The formula for calculating what the farmer gets paid against the prevalent milk price is so complex that farmers themselves have difficulty understanding it. In any case there is no-one to complain to if they feel the calculations are wrong.

5. There is no accountability for the way the milk price is set. It does not follow global milk price when it goes up, not the exchange rate when the value of the dollar goes down. It reflects what the processors want to pay, and seems to be increasingly influenced by their desire to maximise dividends to non-farmer shareholders.

6. If milk fails set specifications it may be collected and used by the processor, but farmers don’t get paid for it.

7. The clawback provisions are just the final straw in terms of unfairness. This appears to allow the processor to withdraw payments made to date and effectively issue a bill to the farmers for payments already made without any justification.

These contracts obviously place farmers in a very vulnerable situation, reflected in mounting farm debt. As some farmers have had difficulty borrowing from banks to meet their cash flow requirements, they have sometimes been offered “rescue” packages by the major processors. The catch is that there seems to be fairly loose disclosure about the terms and conditions that apply to this assistance, and some farmers have found out too late that they are locked into loan repayments with double the interest rate charged by the banks. There are situations just now where farmers are receiving cheques for $0 as a result of the repayments being deducted from their unexpectedly small monthly milk payments, or even bills for what is owed to the processor. Of course this locks farmers even more tightly into supplying the same processor, as they can’t leave until they repay the loans in full.

This is similar to the situation that has previously existed in some developing countries, where processing factories keep their famer suppliers in constant debt by lending them the money they need for next year’s crops, so disempowering them in any negotiations. The difference is that these same countries are reforming the law to extinguish these feudal arrangements.

A contract is normally understood to be something that spells out two way rights and responsibilities. Most of the milk supply contracts fail to meet this test, as they give processors all the rights and farmers all the responsibilities.

In applying unfair contract provisions, processors have been found to be threatening farmers who complain or otherwise cause problems. Farmer Power has had reports from farmers about threats to reject milk on falsified claims of contamination, failure to collect milk, reduce the price paid, or even put into effect repossession of the farm. Contract provisions have been applied in a cruel manner when farmers have been impacted adversely by flooding, with farmers not only losing their income from milk that could not be collected, but also being penalised with huge fines for failing to meet targets for milk supply.

While not all processors have resorted to such intimidatory behaviour, we believe that many processors have abused their power within the industry, and that farmers have been the victims of their unconsicionable behaviour. Farmers wishing to stand up for their rights have been left to mount legal action themselves, involving resources and timeframes that they do not have, whereas we feel that the Government should act to clean up the industry and save the farmers.

Further industry regulation has been imposed on dairy farmers by the Government since deregulation, possibly without the full consequences being realised. Here is the story from one farmer recently posted on the Farmer Power facebook page.

> " *We use to pay a once a year fee on the amount of cows we milked annually. The cost was calculated based on the herd size. For us at the time, it was about $150 per annum. This was paid to Dairy Australia as part of our dairy licence. Of course that all changed a couple of years back! They obviously weren't making enough money! We now pay 3 fees:*
> *Dairy Food Safety Licence @ 0.0159 c/ltr*
> *Dairy Australia Butterfat kgs @ 2.9263 c/kg*
> *Dairy Australia Protein kgs @ 7.1299 c/kg*
> *It doesn't seem to be much but I can tell you, it all adds up!! What does all this mean? Basically, it's now costing us approx $300 a month!! So that's a whopping increase of 2400% !!!"*

These calculations apply to a relatively small farm. Farmer Power estimates that the average sized dairy farm is paying $8,000 per year to Dairy Australia in compulsory payments automatically deducted by processors from their milk cheques. In a situation where many farmers are making a loss, this impost can make the difference between putting bread on the table or not.

The compulsory payments made for Food Safety can perhaps be justified as being in the interest of the industry as a whole. However the compulsory payments to Dairy Australia do not seem well justified (see below). In any case, it is not appropriate for these payments to be compulsory, and Farmer Power is advocating for these to be voluntary as with most other industry bodies. That way there would be a clear incentive for Dairy Australia to demonstrate that it provides value for money to its subscribers.

The Role of Dairy Australia

Dairy Australia is an industry body that was established in 2003 as part of industry deregulation. It receives around $34M per annum from farmers as a compulsory levy on the farmgate milk price, and another $19M from the Federal Government. It receives around

$30M per annum in additional project funding from a range of agencies. Since deregulation in 2000 it would appear to have received near to $1B in funding, most taken out of the pockets of dairy farmers. It claims to return $3 in value for every $1 invested, so this is a claim for $2-3B of value since its establishment.

There has previously been a review of the operations of Dairy Australia and there is currently another performance review underway. Unfortunately these have been commissioned internally and the first review was carried out by people who may have had an interest in promoting the status quo. We believe a fully independent review is appropriate.

While dairy farmers have been receiving less and less for their milk, and milk production has been falling as a result, Dairy Australia has sought to bolster its funding by increasing the levy on dairy farmers. Against much protestation about the process for achieving this, Dairy Australia recently amended its constitution so that it can raise the levy with minimal consultation. As milk supply drops further, it can be presumed that Dairy Australia will continue to raise the levy on the remaining farmers to maintain its coffers.

Dairy farmers are understandably concerned about the value for money they receive from their significant investment. They could have reasonably expected that Dairy Australia would have highlighted the dairy industry crisis to government, given that the crisis has been building since 2013. It could also have expected that there would be a plan for addressing the problems in the industry.

Ask dairy farmers what the main problem is with the dairy industry and they will blame it on the farmgate milk price, yet curiously this receives scant attention in Dairy Australia's reports. Could this be because the board of Dairy Australia is dominated by individuals who are linked to major dairy processors? While the constitution does provide for some dairy farmers to be elected onto the board, the actual election process has been likened by some to the democratic processes adopted in North Korea. Farmers are able to propose candidates for election to some of the board positions, but the existing board members then cull the list of nominees to a handful of "suitable" candidates. These are often individuals for whom farming is a secondary interest, and some are board members of the major processing companies. In practice the board appears to be heavily influenced by people with a financial interest in the major dairy processors, in a situation where the processors do not contribute funds to the running of the organisation. There is particular linkage between individuals on the board of Dairy Australia and board members of Murray Goulburn.

The 2013-16 Strategic Plan identifies the industry priorities as farm profitability, sustainability and reputation management. The plan's objective is "*to impact existing negative industry sentiment, improve farmer confidence and encourage investment in both financial and human capital*". The plan allocates over $20M per year to increasing farm profitability and competitiveness.

Dairy Australia states its role as "*to help farmers adapt to a changing operating environment and achieve a profitable, sustainable dairy industry*". This includes funding and managing "*central pre-competitive activities that are important to the future of the industry but would not occur effectively or efficiently if the market was left to its own resources*". These statements give rise to several questions:

1. What does this mean?
2. What has Dairy Australia actually achieved in fulfilling its charter and deploying its enormous resources to help dairy farmers?

This plan, as with previous plans and reports, suggests that Australian milk production will steadily increase. Each year, the reality is that it trends downwards. However Dairy Australia is not held to account for its failed strategies, and simply recasts its focus as "reversing this trend".

The plan comments on the impact of cheap homebrand milk as follows. "*The recent strategies of the major retailers will help support on-going low priced house brands. These strategies will inevitably damage the sales of branded milk to the benefit of house brands, and enhance the power of the retailers in the local milk supply chain. DA has limited ability to impact retailer strategies but it can help improve farm profitability via investment in the development of new and higher margin products and on-going productivity improvements on farm and within the processor sector."* Clearly this strategy has failed.

Much reliance is put on increasing milk yield per cow as signalling success for the industry. However this is likely to be achieved as a result of less productive older cows being culled, often reducing the productive life of dairy cows (reducing the economic return per cow over its lifetime). This reduces calving rates and results in long term herd reduction. Increased yield per cow may also signal abandonment of dairying on less productive pastures as the industry contracts. Rebuilding the industry needs to focus on total quantum of milk produced not yield per cow.

Successive surveys of farmer confidence by Dairy Australia paint a picture of significant hardship and increasing likelihood of farmers leaving the industry. Amazingly the response in the plan is to change the culture rather than addressing the hardship. Imagine how financially stressed farmers feel when they read the following. "*The current culture of the Australian dairy industry provides limited support or opportunities to celebrate success, with most attention focused on those who are struggling with the challenges of market and climate volatility. This is reducing the overall confidence of the farm sector in profitably supplying growing dairy markets and limits the attractiveness of the industry for investment of both financial and human capital*." So apparently it's not the economy, it's the farmers' fault!

The strategy proposed for addressing this cultural problem is to "*create roadmaps to wealth, including entry pathways*" and to "*celebrate success on farm on wealth creation*". Another strategy is to "*adopt a front-foot approach to sustainability based on the industry's framework*". The strategies proposed for improving farm profitability (which is identified as the top strategic priority) make no mention of the farmgate milk price.

Those with an interest in effective planning would be hard pressed to find any tangible strategies in the Dairy Australia plan. There are no clear performance targets or measures, no allocation of responsibilities and timelines, and no inbuilt accountability for the funds expended.

It appears that Dairy Australia has no plan for taking the industry forward post 2016. Its only apparent response to the current crisis has been to bring forward the launch of a program (Tactics for Tight Times) on building farmers' "emotional resilience", and to provide $1M of funding (presumably for counsellers) as part of the Victorian Government's very limited package of assistance. Providing funds to redress the factors behind farmers' emotional vulnerability does not seem to be on the agenda.

Farmer Power questions how Dairy Australia as a whole can justify its existence and its claimed $2B+ worth of value when it has overseen the current industry collapse without offering any constructive solutions.

What are the Solutions

During the current crisis, questions have been asked about why the dairy industry should receive Government intervention, and whether it would set a precedent for other farming sectors.

The dairy industry is different for the following reasons.

1. Milk supply has been legally defined as an “essential service” because of the importance of milk in the diet of children.

2. Dairy farmers are forbidden by regulation from selling raw product directly to consumers, and are therefore beholden to milk processors.

3. Milk is a highly perishable good which has to be kept refrigerated on farm at considerable cost to the farmer.

4. It is the most consumed foodstuff in the Australian diet.

5. The restrictive nature of milk supply contracting puts dairy farmers well outside a “free market”, and a buffer is needed against unfair treatment.

6. The milk supply chain is structured so that reduced margins and financial risks are passed on by the larger supermarkets and major processors to the farmers in the most brutal of ways.

7. The present crisis is not just the result of fluctuating market conditions, but rather opportunistic price gouging by the major milk processors to subsidise shareholder dividends.

The scale of Australia’s dairy industry provides further justification for intervention:

- dairy is worth over $25B per year to the economy taking into account its immediate multiplier effect

- it accounts for around half of the economy of many rural communities

- without intervention, the current crisis will turn Australia from a significant exporter to a net importer within two years, with loss of food security and food quality

- the predicted 25-30% contraction of milk production over the next two years (on present trends) involves immediate loss of around 30,000 jobs in areas where alternative employment is not available, with further flow on effects over time

- The welfare costs of this displacement could be at least $500M per year paid by taxpayers ($5B over a ten year planning horizon).

The importance of the dairy industry to the Australian economy and the wellbeing of Australians is therefore a further case for intervention to save dairy farmers who will otherwise give up their farms (by choice or necessity).

Farmer Power has suggested that the previous levy on the price of milk could be introduced as a temporary intervention measure, until such time as a more permanent industry solution can be found. A 50c per litre levy could be redistributed to all dairy farmers providing a top up payment of around 12c per litre, which would bring farmgate milk prices to a more sustainable level. Dairy farmers recognise that a dairy levy would not solve all the problems in the industry. However it would be one strategy that could be easily implemented to help retain farmers in the industry and it has broad support from consumers.

A longer term solution would be to introduce a mandatory code of conduct that requires fair treatment of dairy farmers by processors. This would include introduction of fair two-way contracts, establishing transparency in pricing of milk, benchmarking price to agreed market indicators, and providing for affordable and fast dispute resolution/compensation mechanisms. The enforcement mechanisms should be funded by the processors.

We are unsure what resources are available to the Senate in making a full inquiry into the industry's problems, and the Senate's power to implement solutions. We suggest that the Senate might consider calling for a Royal Commission if further inquiry is appropriate. We do not have much faith in a ACCC Inquiry, given that it is already five months since the ACCC was asked to assess Murray Goulburn's clawback and it has yet to provide an opinion. We also think that turning the dairy industry around will be beyond the ACCC's remit.

What we need is a concerted effort by farmers, processors, retailers, governments and industry peak bodies to rebuild the Australian dairy industry, starting with restoration of milk production. We support Bega head Barry Irvin's call for a complete change in culture to rebuild trust between farmers, processors, employees and consumers, but we would add governments to this list. Nothing less will save the industry.