2 November 2009

Senate Economics Reference Committee

I provide the following submission to the inquiry into Competition and Pricing in the Australian Dairy Industry.

Dairy in the Forrest Electorate

Approximately 96 per cent of the Western Australian Dairy Industry is located in the South Western region of WA (ABARE conference paper .08.9 for the Bunbury / Regional Outlook conference), a majority in my electorate of Forrest.

Currently approximately there are only 170 dairy farmers left in WA, expected to produce around 340 million litres of milk, representing around 3.7% of national milk production. The average age of these dairy farmers is 58 years, there is no queue of potential new young dairy farmers.

Milk supply is insufficient over the summer months to meet local domestic demand which has seen milk brought into Western Australia from other parts of Australia.

In 1999-2000 there were 419 recorded dairy farms in Western Australia. This number significantly reduced to 359 farmers in 2000-01 and just 186 dairy farmers in Western Australia in 2007-08 (Dairy Australia).

According to the 2006 Census data, a total of 621 people were employed on dairy farms, 103 by the dairy wholesale sector and 14 in dairy product manufacturing in my electorate during 2006.

The Western Australian Dairy Industry

In Western Australia dairies average more than 300 cows each which equates to approximately 81,000 milking cows. The average annual milk production per cow in Western Australia in 2006-07 was 5,235.

Western Australia delivers very high quality fresh products to its domestic and export customers. The state also has state-of-the-art processing facilities owned by local and international companies.

Importance of the Western Australian Dairy Industry

Western Australia's dairy industry is an efficient producer of high quality milk for local and South East Asian markets.

The estimated value of farm milk production in WA for 2007-08 was $109 million with the value of dairy products exported from WA $49 million.

History of the Western Australian Dairy Industry

The Dairy Industry Authority of Western Australia was established under the *Dairy Industry Act* 1974 to regulate the production of milk, ensure the continuous availability of milk, oversee the payments and sale of milk and ensure the quality, production and treatment of milk at dairies.

The Authority administered a system of market milk quotas and a licensing system and determined the market milk price, administered various production, promotion and transport allowances, and financed the Distribution Adjustment Assistance Scheme.

The Authority also maintained industry statistics and conducted research into policies and market conditions as well as operating a technical and quality program for farm milk and monitoring the standards of Western Australian manufactured dairy products.

The market milk quota system had operated in WA since the 1940s. Western Australian dairy farmers, through this authority, had the opportunity for input into pricing based on the costs of their production.

It has been recorded that following de-regulation of the dairy industry in 2000, farm cash income of WA dairy farms fell while nationally farm cash incomes increased such that the two became more closely aligned.

In Western Australia, average milk production per farm fell significantly.

Terms of Reference

The economic effect on the dairy industry of announced reduction in prices to be paid to producers by milk processors

Milk production has been falling in Australia since deregulation in June 2000. On deregulation average milk prices at farm gate quickly fell by as much as 8 cents a litre (depending on the dairy company supplied and the farmer's former access to market milk returns). The supply response was a continuing fall milk production volumes through the exit of hundreds of producers (Connections Australian Agribusiness and Food Systems 2002). This exit continues and reduction in volume continues.

Dairy Australia's current forecast milk production is for 9.0 billion litres for 2009/10, a 4% reduction on last year however this is compounded by the continuous falls over more than a decade.

For example the 2004-5 production figures were estimated at over 10 billion litres (Dairy 2004 Situation and Outlook).

It is also difficult to be certain as to the actual production as the figures are provided voluntarily by the processors and in the past the figures have not correlated with the known herd numbers in some states. Increases in production take approximately a minimum three years to an average of seven years to achieve. It is easier to reduce production than it is to increase it.

The fall in milk prices may lead to yet another series of farmers exiting the industry, a serious problem particularly where prices fall below costs of production.

It is clear that as the processors 'announce' the price to be paid to producers there is no competitive market for milk and no capacity for farmers to negotiate a price.

Hundreds of individual farmers are prohibited under the trade practices Act from voluntarily appointing an agent to negotiate a fair price for farmer groups who could offer a larger competitive volume of supply. Individual farmers only have the option of approaching two or three processors in their region all of whom offer a similar price.

When production falls it does not necessarily result in the market (processors and supermarkets) responding by increasing the farm gate price. A Sun-Herald article from 13 April 2008 (attached) indicated that processors were using permeate a milk waste product to top up milk volumes by up to 12%. Milk labelling does not require processors to disclose top up using permeate and Dairy Australia figures are not cross checked or audited.

As a result of the ability to 'top up' milk with cheaper waste product or in some cases milk powder there is no clear market link between reduction of supply and increase in farm gate price.

Milk Prices (from Department of Agriculture and Food WA 2006 Dairy Invest Report)

"Since deregulation in 2000 there is no State intervention in the setting of milk prices. Continuous improvement in product mix, markets and growth opportunities have resulted in significant increases in farmgate price over the last 3 years with parity to prices paid elsewhere in Australia achieved in 2006/7. Ongoing development of high value, sustainable markets and significantly less exposure to the commodity sector will protect against commodity price cycles going forward. Processors pay what is required in order to meet their on-going supply requirements in terms of volume and preferred product mix.

Post deregulation, milk prices were inadequate to provide for year-round production or its associated costs and many producers changed calving pattern in order to increase profitability by producing more milk from rainfed pastures. This has resulted in a decline in milk production in the period January to June.

A shortage of milk overall saw the introduction of growth incentives for increased production in 2006/07.

Prices paid by processors vary and price comparisons should be calculated on an individual farm basis due to variation in the prices paid for fat and protein; methods of expressing milk components (mass/mass versus mass/volume); milk quality payments and penalties; growth incentives and deductions for either volume and/or stop charges and in the case of Challenge Dairy Co-Operative, purchase of delivery right units.

Quotas relating to milk volumes, cow numbers or other limits on land use do not apply".

Comment
Falling milk production below demand does not have a direct link to increased farm gate price due to the ability to top up with lower value waste product permeates. There is no legal or labelling requirement to disclose this top up to consumers.

In 2008 processors in Western Australia advised their dairy farmer suppliers that they wanted an increased volume of milk and they would be paying higher prices to secure milk volumes.

In response, the dairy farmers committed to increasing their milk production at a time when they were paying high costs for inputs including fertiliser, water, dairy repairs, supplies and fodder.

Dairy farmers received the higher prices for one month only.

When the processing companies announced that they had cut the prices by approximately 20%, milk producers were left to absorb the higher costs they had committed to, without the returns that they had budgeted for.

The announcement of a reduction in prices to be paid to producers by milk processors has had a significant impact on local dairy farmers, particularly as it came at a time when prices had just started to rise post deregulation in 2000.

The majority of farmers had incurred significant debt in responding to deregulation; increasing herd numbers, building larger more efficient dairies and improving productivity.

Dairy Australia's 'Dairy 2009 Situation Outlook' survey report recorded that 83% of Western Australian respondents indicated that they had been affected by price step downs. Furthermore, 64% nominated milk price as the main challenge currently facing the region.

The report also stated that one of the main challenges facing the WA dairy industry is the aggressive competition in the WA domestic retail market for milk and fresh dairy products, featuring discounting in both the white milk and UHT sectors.

As a result of their vulnerable position as price takers in the supply and value chain, many dairy farmers are not achieving commercial returns in their businesses.

A dairy farmer from the Forrest electorate stated that he is currently receiving around 40 cents a litre for his milk, however he is worried about his costs and milk prices long term.

'Farmers need to take a realistic price from milk processors to ensure the sustainability of the local industry' he said.

Another dairy farmer stated that the current milk price being paid to farmers is an unrealistic price for what farmers need to remain sustainable in the long term.

An article in a local paper, the South Western Times, highlighted in a previous article in July which stated that the drop in the export market dictated the prices dairy farmers were receiving and successive price cuts were limiting farmer's ability to keep farms to a high standard.

Western Australia's 170 dairy farmers are innovative and progressive, otherwise they would not be in business.

In the past few years dairy farmers in WA have been faced with various challenges and cost increases including difficulties sourcing fodder due to price and unreliability of supply, increased electricity costs, increased export competition and a lack of farmer confidence.

Local dairy farmers have also been faced with the numerous reports of late that large amounts of subsidised skim milk powder from the United States were dumped into Australia's major Asian market in August this year.

As an article published in the Australian Financial Review on 6 July 2009 entitled 'US dairy dumping hampers recovery' states, Australia and the United States are in direct competition for selling dry milk products to the South-East Asian market. Therefore, the US subsidy program is and will continue to have a detrimental effect on the global commodity price.

There have been reports of an increase in dairy heifer exports to China due to the low milk price (Countryman - 16 July 2009, page 9). Local producers believe that if milk prices do not improve more Western Australian heifers will be exported to the Chinese market.

The issue of subsidies within the export dairy market is very important for dairy farmers in the Forrest electorate and requires urgent attention. I have written to the Minister for Trade, Simon Crean asking for information on his current and planned actions regarding this issue.

Minister Crean recently replied stating that the Australian Government has actively and vigorously protested against the use of export subsidies, through representations at the highest levels.

But this has not produced any higher farm gate prices for Australian dairy farmers.

Western Australian dairy farmers feel as though they are being dealt one blow after another and are currently knuckling down and trying to produce high quality milk as cheaply as possible. However one local dairy farmer in the attached article of the South Western Times quoted ‘I am running out of belts to tighten’.

The impact of concentration of ownership of milk processing facilities on milk market condition in the dairy industry

In a number of areas around Australia, concentration in the numbers of local processors has led to a situation where there is a monopoly purchaser of milk at the farm gate and no capacity of the farmers to negotiate price. The farmer can only negotiate individually and the price is on a take it or leave it basis. Even where there is more than one processor, prices are often disturbingly similar.

A majority of milk from Western Australia’s dairy region is processed into fresh products.

There are four major companies operating in the Western Australian region; Challenge Dairy, Fonterra, Harvey Fresh and National Foods. The Dairy Australia ‘Dairy 2009 Situation Outlook’ report states;

‘Milk prices in the region paid by the two major companies (National Foods and Fonterra) are driven by a combination of factors which include the price that is achieved by Challenge Dairy from manufacturing; domestic retail market competition for milk and fresh dairy products in the WA market; and the price necessary to achieve a secure floe of milk for fresh product requirements’.

The concentration of ownership of processing facilities further reduces dairy producers ability to negotiate farm gate milk price which eventually impacts on consumer pricing as competition is reduced.

Dairy farmers believe that supermarkets are only paying what they absolutely have to pay for their generic homebrand milk through their tendering system.

Milk processors have to tender low prices to secure the milk volume tenders and therefore this is transferred back to the farmers.

Dairy farmers are price takers and cannot pass on any of their increased and increasing costs of production up the supply and value chain.

Ultimately, the price that supermarkets sell the milk is reflective of what processors offer dairy producers. Given this, dairy farmers in my electorate believe there should be a process or mechanism put in place to reduce or limit supermarkets market power and control.

Graph 1 (below) gives an indication of the typical price being paid to dairy farmers by processors in all states. In Western Australia during 2008-09 the price being paid per litre was $0.42, compared to the national average of $0.49.

Graph 1: Typical Prices being paid by Processors to Australian Dairy Farmers

Typical factory paid prices

		2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08 (p)
NSW	cents/litre	32.5	32.8	30.9	32.9	34.3	35.7	48.6
	$/kg milk solids	4.58	4.64	4.29	4.62	4.80	5.02	6.73
VIC	cents/litre	33.3	24.8	26.7	31.5	32.9	32.0	50.0
	$/kg milk solids	4.45	3.35	3.57	4.23	4.44	4.32	6.68
QLD	cents/litre	34.5	34.8	33.8	35.0	36.6	38.8	51.8
	$/kg milk solids	4.88	4.94	4.72	4.84	4.99	5.38	7.14
SA	cents/litre	31.5	30.3	28.2	30.1	32.0	32.6	48.6
	$/kg milk solids	4.38	4.22	3.90	4.19	4.49	4.57	6.75
WA	cents/litre	28.8	28.2	27.4	27.2	29.0	32.0	41.3
	$/kg milk solids	4.11	4.04	3.91	3.89	4.09	4.49	5.79
TAS	cents/litre	32.7	25.9	27.2	30.9	33.6	36.5	50.2
	$/kg milk solids	4.33	3.43	3.54	4.05	4.39	4.79	6.63
AUST	cents/litre	33.0	27.1	27.9	31.5	33.1	33.2	49.6
	$/kg milk solids	4.47	3.71	3.76	4.28	4.50	4.51	6.69

Source: Dairy manufacturers

Source: Dairy Manufacturers courteous of Dairy Australia

As graph 1 illustrates, the price being paid to Western Australian dairy farmers since 2001-02 have been considerably lower than the average price being paid nationally. This has lead to a reduction in farm profitability and has seen a significant number of dairy farmers in my electorate leave the industry.

I recently spoke to a processor from Western Australia who said after deregulation of the industry in 2000 retailer have opportunity to launch a home brand product as the market was now open to choose whatever processor they wished to deal worth and more importantly it allowed them to distribute milk to any store going through a vendor system.

Six to twelve months after deregulation, when the first supermarket launched home brand, the retail price for milk was $2.29 and the price for home brand was $1.99. This meant that consumers still had choice to purchase retail milk or home brand milk as the difference was only $0.15 per litre.

The processor highlighted that today the retail price of milk is approximately $3.55 and $2.47 for home brand. This means that there is now a gap of $0.54 per litre which makes home brand milk more appealing to consumers.

The Sun-Herald article on 13 April 2008 raises the issue of permeates in milk production in Western Australia. The article accuses the big milk companies of misleading consumers by adding a 'watery by-product' to supplies to help maximise products. Many dairy farmers believes if permeates are used in the production of milk it should be listed on the ingredients list.

'Why hide it from the public?' Consumers are purchasing a product that they believe is pure milk, when it could well be something that is concocted in a lab.

I understand the permeates are not used in the East coast, however three of the four Western Australian processors have the ability to be using the waste product. The process believes the use of permeates should be better controlled as the addition of the waste product could be making the farm gate price of milk cheaper for those using it which would have a negative impact on both dairy farmers and other processors who are not using permeates.

Another issue the processor raised was the fact that the two major retailers in nation own approximately 76% of the retail space and therefore have the power to control where processors can sell their product.

Many farmers in my electorate believe that since deregulation, major retailers have gained sufficient market control of the retail milk market and that they can, and do where required, discount generic brand milk as a loss leader to increase general custom.

This results in lower prices to dairy farmers. The dairy farmer is therefore subsidising the major supermarkets low generic price and increasing market share.

Furthermore, it has been suggested that that other countries, mainly New Zealand, have much greater influence on Australia's farm gate outcomes than prior to deregulation.

Dairy farmers in my electorate would like to see more balance between processors and farmers to allow for efficient and effective processing.

The impact of the concentration on milk market conditions in the dairy industry

In Western Australia supermarkets have all of the market power in negotiating supply contracts is very high due to the volumes they purchase for homebrand milk and the high percentage of generic milk that is sold. However, processors bidding for these contracts are able to bid knowing that they have the ability to control the farm gate price and pass the lower tender prices back to farmers.

In 2008 generic brands accounted for 56% of total supermarket milk volumes, a considerable increase from 25% in 1999-2000 (Dairy Australia, Australian Dairy Industry in Focus 2008 report).

The price of milk at the supermarket over the last six months has been approximately $2.35 a litre, however it has recently come back to $1.99 a litre for a 2 litre container. This is the same price that was being paid for milk on special four years ago, if not longer.

The Australian Bureau of Statistics recorded that the average retail price of milk in the six capital cities has fallen by an average of 7% from the recent peak price in 2007-08. This comes when the price being paid to Western Australian, and Australian dairy farmers has fallen considerably.

Whether aspects of the Trade Practices Act 1974 are in need of review having regard to market conditions and industry sector concentration in this industry

One of the contributing factors to the failures in the dairy sector may be because processors are masking falling production and farmers have no real capacity to negotiate a fair price for their product.

1. Supermarkets are not being given clear price signals when production falls below demand.
2. In turn processors need the capacity to clearly indicate to supermarkets that the supermarket pricing policies are unsustainable rather than simply using permeate products to top up volumes. Food labelling should require a clear definition of fresh whole milk and the disclosure of milk additives, similar to fruit juice labelling.

3. Processors cannot effectively negotiate with duopoly supermarkets in Australia – prices to processors and farmers are falling whilst supermarket price increases in Australia have been for some years the highest in the western world. (Retail Traders Association, 1 May 2008)
4. Farmers need to be given the capacity to effectively negotiate by voluntarily using a joint agent to negotiate prices between the groups of farmers and the monopoly/duopoly processors. Large numbers of small dairy farmers cannot effectively negotiate with monopoly/duopoly processors or supermarkets.
   Dairy Farmers and other farmers who produce commodities should be permitted to access the business collective bargaining process notification process under the TPA (see attached media article dated 29 October 2009).

5. The ACCC should take into account the sustainability of food production in Australia as part of the consumer interest. The ACCC should be able to utilise a broader definition of public interests rather than simply being limited to retail price:
   a. Public interest should include the right to have foods properly labelled so that consumers are properly informed of the product they are buying;
   b. Take into consideration whether the industry structure would result in the loss of food production and whether that loss of local food production is in the public interest. The ACCC should be specifically charged with joint responsibility with the other relevant Government Departments and Agencies for ensuring Australia's future food security if that security is threatened by current industry practices. Consumers are not benefited by falling food production.

As this submission highlights, there has been some recognition of the lack of bargaining power of individual dairy farmers. Cooperative ownership of processing facilities by producers has been greatly reduced since deregulation.

There is a need for the ACCC to consider all aspects of supply when looking at competition in the market place.

There is no future in ensuring competition in the retail sector if dairy farmers are unable to supply milk at the price offered even when they are operating at optimal efficiency.

Any other relevant Information

Imitation cheese

Imitation (analogy) cheese, is a growing competitor to ingredient cheese, and is an emerging issue for the European dairy sector.

This imitation cheese is displacing cheese predominately in the fast food sector, as an alternative cheese topping for the pizza industry. The cheaper alternative is made from vegetable oil, casein and various flavours and salts. The imitation cheese is cheaper than natural cheese.

Estimates suggest the imitation cheese usage has surpassed 20,000 tonnes in the EU, which represents less than 1% of the market.

Dairy farmers are absolute price takers with no capacity to pass on any additional or increased costs they may incur. Many dairy farmers are worried that young people will be lost from the industry due to the lack of return from dairy farming. This is of huge concern as it is estimated that the average age of dairy farmers in Australia is 58.

One local farmer quoted 'who would want to milk cows these days, the cost of production is too high, the value of land to high and we are not making enough profit?'

The issue of food security is also of concern to many WA dairy farmers. Does the Australian public want to have local, fresh milk dairy products readily available at their supermarkets?

If there is no sustainable commercial return on investment to dairy farmers they will be unable and unwilling to invest in the industry.

There is no doubt the market concentration and market power influences prices paid to dairy farmers in West Australia.

Please find attached a submission from Mr Leslie Chalmers, Director of The Productive Edge. Also attached are some press clippings from local newspapers regarding this issue.

I thank the Committee for your consideration of this submission. Should the committee require any further information, please contact Lara Swift from my office on (08) 9725 2300.

Yours sincerely

Nola Marino

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Opposition Whip