1 March 2011

Senate Economics Reference Committee

I provide the following submission to the inquiry into the impacts of supermarket price decisions on the dairy industry.

Dairying 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 of it in my electorate of Forrest.

In 1999-2000 there were 419 dairy farms in Western Australia. This number significantly reduced to 359 farmers in 2000-01. Currently there are only approximately 170 dairy farmers left in WA who are 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, and there is no queue of potential new young dairy farmers.

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.

Milk supply in Western Australia peaks in spring, however is insufficient to meet the local domestic demand over the summer months. This has seen milk brought into Western Australia from other parts of Australia at this time of the year.

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

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 for the same period being $49 million.

History in 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 along with 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 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 the average milk production per farm fell significantly as a result of this.

Terms of Reference

The impact on the Australian dairy industry supply chain of the recent decision by Coles supermarket (followed by Woolworths, Aldi and Franklins) to heavily discount the price of milk (to $1 per litre) and other dairy products on the Australian dairy industry, with particular reference to:

I am highly concerned that the decision by the major supermarkets to heavily discount the price of milk will have a negative impact on both the Western Australian and entire Australian dairy industry.

When supermarkets engage in a battle for market share through the long term discounting of milk, lower prices will almost certainly filter back to dairy farmers, who can expect a reduction in farm gate price.

Therefore, I suggest that the question that this Senate Committee really needs to ask is "do we want to retain an Australian dairy industry"?

I believe that the last thing people want to see is more dairy farmers squeezed out of the industry and more local jobs lost and their communities under pressure just to give one supermarket chain more market share and greater control over the supply chain than another.

Farm gate, wholesale and retail milk prices

The average price currently received by a Western Australian dairy farmer is 38 cents per litre, and the average cost of production is around 35 cents a litre. This slim margin clearly demonstrates that they cannot take any more price reductions and remain viable. It is an indictment when water in supermarkets is priced higher than milk.

Dairy farmers, their families and their communities are hurting, with many dairy farmers losing money.

According to ABARE, the proportion of Australian farms with a negative farm business profit hit a peak in 2004-05 of 61 per cent. Of those making a profit, many in the farm sector have incomes equivalent to welfare.

In short, many Australian dairy farmers are losing money and many others are making the equivalent of the dole —and we are expecting people to work under these conditions and provide us with a staple food that is the best in the world.

The only way many dairy farmers can afford to keep farming is to simply go further into debt or eat into their capital, or both.

According to ABARE, in the six years prior to 2008 average farm debt increased from \$237,000 to \$494,000. At the same time, incomes for dairy farmers have stagnated, averaging over the same period a two per cent return on investment.

The return for dairy farmers only reaches levels acceptable to most businesses in Australia by including capital growth in their net return; that is the price of their land has increased and when this increase is written in as a cash return annually, the overall return to dairy farmers is 8.2 per cent. However, this level of return requires the farmer to sell their land to access the money, which then prevents them running their business. This outcome is nice if you are ready to sell your farm and retire but useless if you are not, and hopeless should one of your family want to carry on farming after you.

Such economics also prevents new farmers entering the industry!

It costs money to produce milk, and in this debate we must be prepared to acknowledge this.

I recently spoke to a processor from Western Australia who said after deregulation of the industry in 2000 retailers had the opportunity to launch home brand products as the market was now open. Retailers could now to choose which processor they wished to deal with, and allowed them to distribute milk to any store without going through a regulated vendor system.

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

The processor stated that the retail price of branded milk is now approximately \$3.55 for two litres and thanks to the supermarkets price war \$1.99 for home brand. This means that there is now a gap of \$1.56 per litre, which undermines branded milk products.

Over the past month in supermarkets in my electorate it has been noticeable that branded milk products have been continually on sale at a discount in an attempt to be more competitive against home branded milk.

This highlights that the market in which milk sales operates has been altered by the supermarket's decision to heavily discount home branded milk. Lower priced home brand milk drives the rest of the market down.

In Western Australia Coles has given just one of the processors a five cent per litre increase in price, which is intended to be passed on to producers. This increase in the price being paid to a processor is in my opinion an admission by Coles that retail market warfare is having an impact on farm gate price and thus farm viability.

This was recently confirmed by Woolworths in media comments on February 28th this year, in which the Woolworths spokesman confirmed their belief that the current price war was undermining the long term viability of the industry.

While the five cents a litre increase may assist the few Australian dairy farmers who supply to that one processor (if the increase is passed on to farmers), it does not resolve the issue of downward pressure on retail, wholesale and farm-gate prices that the retail market share war has created. Most farmers who supply other processors are still expecting price reductions in the next round of price negotiations.

I understand that processors in Western Australia are selling very little branded milk products to the two major supermarket chains as a result of the price war.

Given this, I ask the Committee to investigate whether processors are using branded milk products to subsidise the low price they receive for home brand milk.

The decrease in Australian production of milk from 11 billion litres in 2004 to 9 billion litres in 2011, of which only 25 per cent is drinking milk

Milk production has been falling in Australia since deregulation in June 2000.

Upon deregulation the average milk prices at the 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 to this was a continuing fall in milk production volumes through the exit of hundreds of producers (Connections Australian Agribusiness and Food Systems 2002). This exit continues and the reduction in volume continues.

When production falls it does not necessarily result in the market (processors and supermarkets) responding by increasing the farm gate price. It has been indicated that processors have been using permeate, a milk waste product, to top up milk volumes by up to 12%. Milk labelling laws do not require processors to disclose topping up milk by 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.

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.

Whether such a price reduction is anti-competitive

A processor in my electorate raised the issue that the two major retailers in this 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 enough market control of the retail milk market 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 resulting increasing market share.

Dairy producers are absolute price takers. The negotiations they have with their processors and, by default, supermarkets are extremely one-sided affairs. The supermarket or the major retailer, via the processor, will tell them the price they are going to receive.
The price that the supermarkets dictate will govern the price the processor can afford to pay to the grower.

In a state like Western Australia, which is a majority liquid milk producing state, the effect of this price setting has a greater impact on farmer's viability than in other states, where more milk is processed into products like cheese and exported.

The short shelf life of fresh milk also dis-empowers farmers in price negotiations. They produce a world-class quality product, but it is perishable. It has to be picked up from the farm, transported, processed and delivered to the market every day. It is not something that can be stored untreated. This in itself creates a vulnerability that I think many consumers do not understand, but it is one that the supermarkets understand because they certainly take advantage of it.
It leaves the dairy farmer in a 'take it or leave it' position.

It is in this setting that the supermarket chains, led by Coles, have decided to engage in a milk-marketing war using deep discounting to steal market share from each other.

The supermarkets have said they will absorb the cost and that farm gate prices will not be affected. If this is true it will be a groundbreaking event because it does not reflect the history of milk pricing since deregulation in 2000.

When asked by the members of the Senate Economics References Committee in its 2010 investigation into the milk industry of May last year the major supermarket chains denied using milk as a "loss leader" – a product sold cheap or below the price needed to gain a return - to attract greater market share.

However the Senate has now instigated another enquiry into the dairy industry, because it appears that the supermarkets are using milk as a loss leader in their war for a greater share of the market.

Given this, how much faith can we put in the responses of Coles and Woolworths in 2010?

I ask the Committee to examine whether the 2010 senate enquiry was deliberately misled on this issue, because the answer to that might determine how much faith can we have in the answers of the supermarket giants in the current 2011 enquiry.

Milk processors have to tender low prices to secure the milk volume tenders for home branded milk, and these low prices are transferred back to the farmers. They are able to bid low because they know that they have the ability to control the farm gate price and pass the lower tender prices back to 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.

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

The suitability of the framework contained in the Horticulture Code of Conduct to the Australian dairy industry

The problems being investigated by this Committee are not 'conduct' issues per se but the result of an imbalance in bargaining power on price.

The focus of the ACCC on consumer price alone and its refusal to acknowledge producer viability and supply chain equity as industry issues prevents growers and processors negotiating a fair price for their product.

A variation on the proposals I have made before in relation to collective bargaining could use the unfair contract law approach.

The *Trade Practices Act* 1974 (**TPA**) and *Australian Securities and Investment Commission Act* 2001 (**ASIC Act**) prohibit unfair contract terms in consumer contracts.

The Act states that a term of a consumer contract will be unfair if the term:

(a) Would cause significant imbalance in the parties' rights and obligations arising under the contract;
(b) Is not reasonably necessary in order to protect the legitimate interests of the party who will be advantaged by the term; and
(c) Would cause detriment (whether financial or otherwise) to a party if the term were to be applied or relied on.

At present the provisions only apply to consumer contracts for the supply of goods or services (or sale or grant of an interest in land) to an individual whose acquisition of the goods, services or interest is wholly or predominantly for personal, domestic or household use or consumption.

The Act only applies to standard form contracts and at present does not apply to business contracts. Providing for this section to apply to commercial business dealings could go some way to address the imbalance in the current situation with dairy farmers.

TPA unfair provisions affect all corporate entities, and each of the States is passing corresponding legislation to pick up unincorporated entities such as partnerships and individuals.

Prosecutions are of course rare, and while we would not want to rely exclusively on the ACCC for enforcement it would certainly help.

The recommendations of the 2010 Economics References Committee report, **Milking it for all it's worth – competition and pricing in the Australian dairy industry** ***and how these have progressed***

As this Committee is aware the final Senate report, *Milking it for all it's worth,* was released on the 13 May 2010 and provided 15 recommendations aimed at bringing balance back to the dairy industry supply chain.

Given the issues confronting dairy farmers, I believe that the Government needs to respond to the recommendations of the former inquiry as soon as possible.

I personally wrote to the then Minister for Agriculture, Tony Burke, asking for the Government's response on the recommendations delivered by the Senate's national inquiry into the dairy industry last year. I am still waiting for a reply.

Market concentration and the market power of supermarkets affect dairy farmers, particularly in Western Australia. Dairy farmers need support and action, and they deserve an honest answer from supermarkets about the use of milk as a loss leader. This enquiry must determine if the last one, less than a year old, was misled.

The need for any legislative amendments

It is clear is 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 fair price.

One of the contributing factors to the failures in the dairy sector may be that farmers have no real capacity to negotiate a fair price for their product.

Supermarkets are not giving clear price signals when production falls below demand. 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.

Large numbers of small dairy farmers cannot effectively negotiate with monopoly/duopoly processors or supermarkets, so farmers need to be given the capacity to effectively negotiate by voluntarily using a joint agent to negotiate prices between groups of farmers and the monopoly/duopoly processors.

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).

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

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 interest than simply being limited to retail price. That definition of public interest should include the right to have foods properly labelled so that consumers are properly informed of the product they are buying.

The ACCC should also take into consideration whether the current industry structure could result in the loss of food production, and whether that loss of local food production is in the public interest. The ACCC with the other relevant Government Departments and Agencies should be specifically charged with joint responsibility for ensuring Australia's future food security, including determining if that security is threatened by current industry practices.

I would contend that consumers are not benefited by falling food production. Neither is there any benefit 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.

As this submission highlights, there has been some recognition of the lack of bargaining power of individual dairy farmers.

It should also be noted that cooperative ownership of processing facilities by producers has been greatly reduced since deregulation. This is in contrast to New Zealand, which does not appear to be suffering the same industry dilemmas.

Any other related matters

The majority of milk produced in Western Australia is sold as a fresh white milk product, which means that the impact of a price war for market share will be greater here than in other states.

Australia produces some of the best quality milk in the world and we have some of the most efficient farmers in the world, but we are looking down the barrel of becoming dependent on an imported, UHT long life type product as a result of supermarket milk discounting.

All sectors of the supply chain need to be able to be sustainable if we want to keep fresh milk on the shelves of supermarkets across this country.

I ask the Committee to examine the proportion of the cost of each litre of milk that goes to each section of the supply chain (farmers, processors and retailers) and to look at whether this varies during the process of discounting milk in order for supermarkets to gain additional market share.

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

However, I remain concerned that we will not get to the truth behind this issue because of the market power and dominance of the supermarkets, and because those who could give evidence will be too afraid to do so.

They will not do so because they are dependent on the supermarkets to sell their products, to the point that they might be out of business if they do speak out.

The market share and market power of the major supermarkets, including their collective buying and selling capacity means that they have the capacity to dictate and dominate.

The barrage of lawyers and consultants they employ will ensure that, in spite of all the inquiries that we might have, we may never get to the truth about the contractual issues and product pricing of the supermarkets.

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

Yours sincerely

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