



AUSTRALIAN COMPETITION  
& CONSUMER COMMISSION

# Dairy Inquiry

## Farmers' guide to the final report

April 2018



The ACCC investigated a broad range of issues that were raised by the industry.

Two key concerns raised by farmers were:

- contract and pricing practices that lacked transparency and gave processors too much power
- the impact of \$1 per litre private label milk on the industry.

### The need for a mandatory code

There is a significant bargaining power imbalance between farmers and processors. Farmers also have limited access to price and market information compared to processors.

Farmers rarely have the opportunity to negotiate prices or contracts with processors. This has resulted in contracts that allow processors to transfer risks onto farmers through terms that:

- allow processors to reduce farmgate prices mid-season
- reduce farmers' ability to switch between processors.

There are also ineffective dispute resolution processes.

The ACCC's view is that these issues are harmful to the efficiency of the industry. The recently developed Voluntary Dairy Code has resulted in some changes, but it is not enforceable and does not offer an adequate long-term solution.

The ACCC therefore recommends that the Australian Government introduces a mandatory code of conduct to apply to dairy processors. A mandatory code would reduce market failures resulting from these issues by improving the quality of information and price signals, enabling fairer allocation of risk, and enhancing competition by removing switching barriers.

### What is a mandatory code of conduct and what should be included?

If the government accepts the ACCC's recommendation, a mandatory code would set minimum standards of practice that would govern the processor-farmer relationship. A mandatory code should:

- include obligations for processors to give timely and transparent information to farmers about the price and non-price terms
- prohibit the use of retrospective step-downs
- remove unnecessary barriers to switching
- provide for effective dispute resolution processes.

Under the ACCC's proposal, a mandatory code would not regulate farmgate milk prices or restrict the types of contracting options that a processor can offer.

If the government accepts the ACCC's recommendation, the content of a mandatory code would be set by the government, who would undertake its own consultation process.

The ACCC would be responsible for enforcing a mandatory code.

### \$1 per litre private label milk

To analyse the effect of private label milk on the dairy supply chain, the ACCC used compulsory information-gathering powers to obtain documents and data from supermarkets and processors, and interviewed witnesses under oath.

### What is the relationship between retail, wholesale and farmgate milk prices?

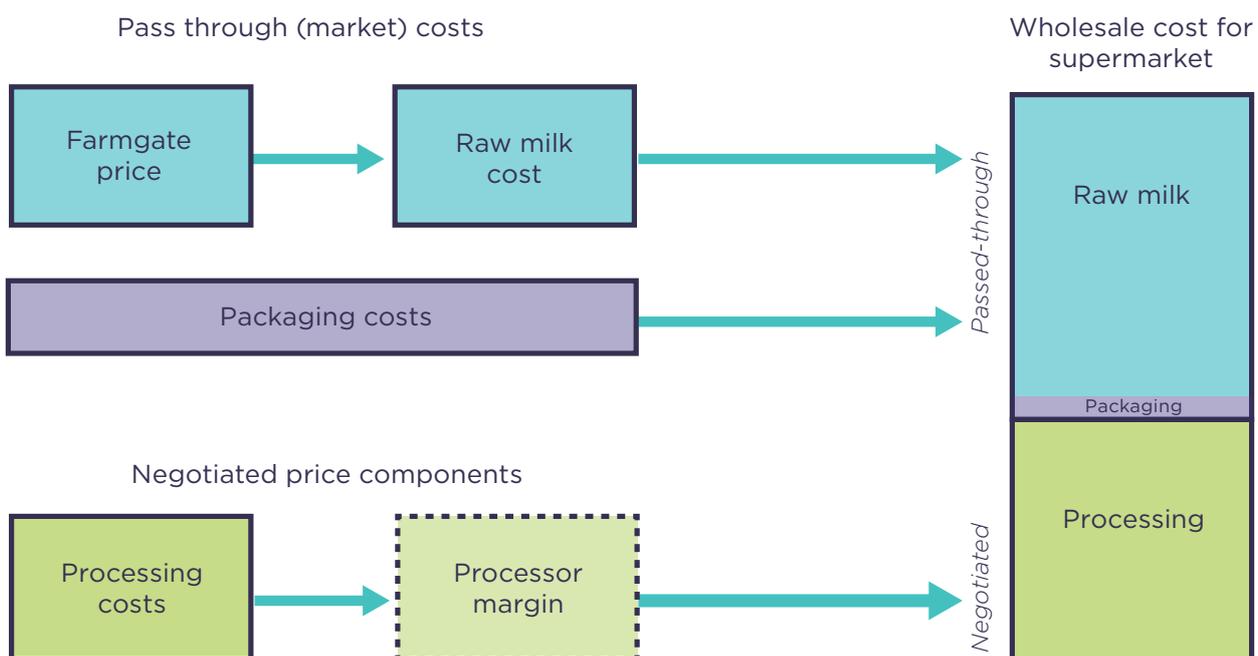
The starting point for the ACCC's \$1 per litre milk analysis was to determine the relationship between retail, wholesale and farmgate milk prices.

- The ACCC found that almost all contracts for the supply of private label milk allow processors to 'pass-through' movements in farmgate prices to supermarkets.
  - This means that processors set their own farmgate prices independent of the supermarkets' retail prices.
  - For this reason, changes to the retail price of private label milk are unlikely to result in any changes to the farmgate milk price received by farmers, because processor profits on private label milk are not influenced by whether farmgate prices are high or low.
  - The ACCC did not see any evidence of supermarkets seeking to influence farmgate prices.

### Does \$1 per litre milk affect farmers indirectly?

- Processors set a farmgate price only as high as they need to in order to acquire the volume of raw milk production that meets their demand in that region. This is rational commercial behaviour and not related to prices they receive from supermarkets.
  - The minimum farmgate price that processors need to pay will generally be higher in areas where competition between processors for milk is the strongest.

### Typical supermarket private label milk contract



- Per-capita consumption of drinking milk does not change much. This means that in Northern New South Wales, Queensland and Western Australia, processors' raw milk demand for drinking milk production is stable from year to year.
  - In these regions, the vast majority of dairy production is for drinking milk, and farming costs are too high to be competitive in export markets.
  - Processors in these regions are faced with relatively fixed demand and have little incentive to invest in expanding capacity.
  - Increases in prices for drinking milk would not give these processors the incentive to buy more milk from farmers and therefore do not influence farmgate prices.
- In the other dairy regions (South Australia, Southern New South Wales, Tasmania and Victoria), most farmers' milk is used to produce exportable dairy products. Only a small amount of milk from these regions is used for private label drinking milk. In these regions, farmgate prices and profit movements reflect global dairy commodity price changes.

## Other conclusions

The ACCC considered a broad range of other issues under the Terms of Reference. Key conclusions include:

- there are shortcomings in the timeliness and reliability of pricing signals given to farmers before the start of a dairy season
- announced farmgate prices do not reflect actual prices received for many farmers
- there was no evidence that the timing of farmgate milk price announcements involves anti-competitive 'follow-the-leader' behaviour
- exclusive supply clauses deliver efficiency benefits for both processors and farmers. They may raise concerns if they have an anti-competitive purpose or effect, and must be assessed on a case-by-case basis
- milk swaps have the potential to soften competition between processors, but the risk does not appear to be high
- milk trades can be used to lessen farmgate competition. However, the specific trades analysed did not appear to have had a significant adverse impact on competition. Further, it is apparent that trades have some industry-wide efficiency benefits.

Analysis of these issues in detail is contained in the report, available at [www.accc.gov.au/dairyinquiry](http://www.accc.gov.au/dairyinquiry)