COMMENTS ON THE ACCC INTERIM REPORT ON THE AUSTRALIAN DAIRY INDUSTRY

The ACCC has invited feedback on its interim report and has specifically asked for comments on a number of issues. Farmer Power appreciates the opportunity to contribute and provides this submission on behalf of Australian dairy farmers. We believe that we are the organisation that most accurately represents the views and perspectives of dairy farmers throughout the country.

We applaud the ACCC for its thorough research and for providing a foundation document that can inform further initiatives to address problems within the troubled Australian dairy industry. We recognise that the ACCC has limited terms of reference within which it can recommend reforms but we hope that its work can connect with other reform strategies. In this way the industry may be able to start recovering its previous important contribution to the Australian economy and the community.

We have organised our submission as follows:

A. Comments on the facts presented in the Interim report

A1 Industry background

The decline of the Australian dairy industry since deregulation can be compared with the rise of the New Zealand dairy industry over the same period. There seems to be little doubt that deregulation in Australia has been unnecessarily damaging to the operating conditions for dairy farmers. Much could be learnt by looking at how Dairy NZ has supported a positive deregulation process, and the failures of both the Australian Government and Dairy Australia by comparison.

We also recommend that the ACCC examines the documentation of Senate hearings held before deregulation to consider what the impact of deregulation would be on dairy farmers. It can be seen from the Hansard records how processors hastened through a format which quite clearly provided inadequate protection for farmers' interests, which was regarded as highly questionable for this reason by the Senators involved in the hearings.

The ACCC's interim report has presented some useful data on the national herd. We would like to see more analysis of cattle sales including herd culling over the past 18 months, as this information should be readily available. Anecdotal information suggests that the national herd may be shrinking as farmers sell stock to pay their bills, or switch to beef production, and the impact of this may be disguised by seasonal increases in milk production due to weather conditions. As is noted below, increasing spring milk production can actually lead to reduced farmgate returns under some contract provisions.

A2 Bargaining power and risk allocation

A current example of how risk is being increasingly passed on to farmers is the current crisis over power prices (which is not reflected in the ACCC report, possibly as Dairy Australia has been slow to identify power as a critical input to dairy farming expenses). There are increasing reports in the media that increased power costs for dairy manufacturers are likely to result in a 1c per litre drop in the farmgate price they pay to dairy farmers, in a situation where dairy farmers themselves are feeling the impact of rising energy costs. So it is projected that farmers will pay not only the costs of increasing energy prices for milk production but also the increased energy costs further up the supply chain in manufacturing.

A3 Farmgate milk prices

Based on our discussions with dairy farmers, and the collective views of other dairy farmer representative bodies, it appears that the farmgate price needs to be at least $6 per kilo milk solids for farmers in southern Australia to break even, and more in the north. This is substantiated by Dairy Australia's annual farmer survey which found that a majority of farmers expect to make a loss this year. The inherited debt from 2015-16 is being reflected in the inability of farmers to pay their bills to their suppliers, which continues to put pressure on regional businesses as well as councils in dairy farming regions. The processors are flagging a likely drop in the farmgate price next year, which would be disastrous for many farmers, leading to further reduction in the national herd as stock is sold off to pay bills.

We would suggest that the simplest way of correcting this situation would be to determine that dairy products cannot be sold domestically at a price below the cost of production. This would be similar to dumping legislation that requires that imported product not be sold below the retail price of that product in the country of origin. Cost of production could be established annually by an independent body based on data that is collected from both farmers and processors, and ensuring this as a floorprice would give both farmers and processors the certainty they need to plan ahead, especially in a situation where domestic pricing is the dominant factor in farmgate milk pricing. While such price intervention might run counter to principles of free market operation, it is clear that the market within the dairy industry is so distorted and anti-competitive that some price intervention is required to ensure the industry's survival.

In our view it is wrong to suggest that milk production has stabilised, as the current price realities will inevitably lead to continuing reductions in milk production as more farmers quit. The reason for reduced levels of bank foreclosure is that banks have realised that the glut of dairy farms on the market means that farm sales will not enable them to recover their loan outgoings. Instead they and financial advisers are advocating diversification or orderly disposal of assets, including herd reduction to pay bills in the short term. This is an impending catastrophe which can only be averted by increasing farmgate prices. We note that the interim report relies on farm exit data from pre-

2015 and we suggest that this should be updated and cross validated. Similarly farm profitability data needs to take account of the latest survey data from Dairy Australia as well as other sources.

There is available information about the number of dairy farmers who are now dependent on welfare payments to sustain their families, and the increasing incidence of welfare dependency. This should ring alarm bells as farm welfare is time limited, and these families may ultimately have to exit farming. Another factor threatening the industry is that the clawback of 2016 had the most severe impact on young farmers including tenant farmers who were in debt after purchasing stock and equipment. There is currently little to encourage new entrants to dairy farming, and the bulk of farmers are approaching retirement. This can be contrasted with the more youthful profile of farmers in countries which support their dairy industry.

We note that the interim report quotes production costs from 2010, which seem to be irrelevant to the current situation. We have previously been critical of Dairy Australia for not producing this essential information as part of its industry monitoring, perhaps because it may not serve the interests of processors to publish these data. We consider that typical processing costs should also be published, so that the whole supply chain dynamic becomes transparent.

The impact of depressed farmgate prices is seen in other ways. While it is difficult to access data on farmer suicides and self-harm, and mental illhealth may also be under-reported, there are available reports about the impact of farm debt on local businesses in the main dairy farming regions, with many having to close their doors. There are some previously prosperous country towns which now have the appearance of ghost towns. Farm closures as well as farm amalgamations also have a severe social impact on regional areas, as farming families were significant contributors to bushfire brigades, as well as sporting and social clubs. Loss of rates and slow payments from cash strapped farmers is threatening the financial viability of local government in these areas, and their capacity to deliver services.

A4 Competition for raw milk

We note that the ACCC has formed a preliminary view that milk swaps and trades between processors has not had a significant effect on competition for farmers' milk in recent years. Even so, we feel there is considerable potential for milk swaps and trades to lead to a situation where a single processors monopolises the milk market in different regions, and processors then trade between regions. This appears to be creeping into the industry to a worrying extent.

The prospect of long haul milk competing with relatively high cost milk in Queensland and WA seems to be dismissed in the interim report, but the figures presented suggest that this situation may be fast approaching. It may also be useful to examine the impact of current milk pricing in which farmers pay a nominal set amount for milk transport, in terms not only of its justification (we think this is unjustified) but also whether this removes incentives for transport rationalisation.

A5 Other competition in the dairy industry

We are concerned that there has not been any consideration given to import dumping of cheese. From our inquiries it would appear that bulk cheese (cheddar and mozzarella) from the USA and New Zealand is being retailed in Australia and supplied to pizza chains at prices well below those in the countries of origin, which constitutes dumping, with some repackaging to present the product as Australian. There is some potential for this repackaged product to be exported to those countries with which Australia has favourable trade agreements, if this practice is not stamped out, as this might serve the interests of some of the overseas companies that now dominate Australian dairy manufacturing.

The interim report comments on the barriers to new dairy manufacturers being established. We suggest one way of encouraging new participants could be to remove the caveats commonly placed on disused plant when this is sold by processors. These caveats prevent future use of the plant for dairy manufacturing, and are specifically designed to reduce competition. The waste of resources is particularly objectionable when the processors have previously received government grants to build the plant that is no longer in use.

A6 Supply chain profit analysis

The ACCC report suggests that it takes 10L milk to manufacture 1 kilo of hard cheese, and this means that selling bulk cheese for $6 per kilo equates to selling drinking milk at 60 cents per litre. This is not quite right, though we believe that the retail pricing of cheese is being forced down by what appears to be import dumping, and it is barely profitable at the quoted price. Our research indicates that efficient cheese manufacturer would produce 1 kilo cheese from 9 litres of milk (or less), and would gain additional value from processing the whey byproducts (ricotta, whey powder, WPC etc). However we would suggest that a retail price of around $8-9 per kilo is required to ensure sustainable returns through the supply chain. This was the prevailing price until the flood of cheap imports seen during 2017.

We strongly suggest that the ACCC should reconsider its findings about the impact of dollar milk on the industry. We agree with the ACCC's observation that any moves to increase the minimum price of milk would not result in any benefit flowing to farmers in the present supply chain power structure. However this issue deserves a less flippant commentary. Please consider the following:

- It is factually incorrect to assert that the consumer switch to purchasing name branded milk in early 2016 (following a campaign led by Farmer Power) has been reversed back to pre-2016 levels. This is what processors initially claimed would happen, and they made submissions to this effect to the recent Senate Inquiry. Dairy Australia also initially claimed the switch would be short lived. However the latest data from Dairy Australia shows that much of the change in consumer purchasing behaviour has been maintained.

- The fact that the switch to purchase name branded (more expensive) milk did not result in better returns to farmers does not mean that this would be the case if there were complementary measures. For example, the Queensland Dairy Organisation has supported the introduction of labelling that guarantees a minimum return to farmers, and if this was combined with a campaign for consumers to support farmers, there would be ways of ensuring the benefits would flow to farmers.

- The <u>indirect</u> impact of dollar milk requires more discussion. The report clearly shows how the price of name branded milk has followed that of homebrand milk in an effective race to the bottom. It may be true that farmers supplying name branded milk are paid the same as those supplying name brands, but one cross-subsidises the other, so the result of the downward pressure on prices is that there is less money in the overall pool, and farmers' returns are minimised to make up the shortfall. It used to be that a relatively high price of domestically sold drinking milk was a cushion against the fluctuating global price, but it now is a significant factor in reducing overall farmgate milk pricing. The introduction of homebrand milk effectively changed the way milk was priced at the farmgate, with supermarkets effectively becoming processors who contract out production, avoiding price negotiation with farmers.

- We do not see any evidence to support the report's suggestion that discounted retail prices will eventually rise because they are not sustainable for processors in the long term. If there was concern for the overall sustainability of Australia's dairy industry, then both supermarkets and processors would be incentivising farmers to produce more milk by paying them a sustainable price. Instead it seems to be that the big corporations are each fighting for market share and hoping their competitors will suffer.

- Processors have competed for supermarket contracts in order to get market share of milk supply, as this can produce efficiencies of scale in processing, as well as strengthening the negotiating power with farmers. However another factor is that supermarkets have negotiated these contracts with access to shelf space for name branded products as a bargaining chip. The initial contract between Coles and Murray Goulburn is widely reported as involving a return of access for Devondale products, which had previously been taken of the Coles shelves.

- Suggestions about efficiencies of scale resulting from securing homebrand supply contracts may be deceptive. In the case of Coles, $150M was spent on new plant to process homebrand milk. When the time came to renegotiate the contract, it seems that M-G could not afford to lose the use of this plant, and it is reported that Coles was able to shave a further 10% off the returns to the processor. This demonstrates the short term thinking of our major processors, or perhaps just bad judgement by M-G. It would be interesting to find out whether this squeeze on processor returns had any part to play in M-G's downfall (or conversely whether a more realistic return from homebrand milk supply would have saved the company).

We have appended to this submission our own commentary on the introduction of dollar milk into the domestic market, and its impacts, for your information.

In relation to tracking global dairy commodity prices against Australian supply chain returns, we note that the ACCC has exclusively referred to the GDT index. This is heavily influenced by Fonterra's trading behaviour, and may be subject to some pricing bias for this reason. There are other indices from the USA, the UK and The Netherlands as well as those maintained by some international banks which may provide more effective international benchmarks. The Netherlands data has suggested that the price paid by Australian based processors to farmers is lower than that seen in most other dairy producing countries, regardless of global price trends. While New Zealand farmers are sometimes paid at a comparable rate, this is mitigated by other factors (dividends from co-operative structures, lower production costs due to climatic conditions, and a more supportive regulatory structure).

One aspect of the industry that does not receive attention in the interim report is research leading to innovation. Australia's dairy research capacity has been considerably reduced over the past few years, with the closure of the CSIRO dairy unit (and abandoned commercialisation of high value innovations) and the more recent withdrawal of funding and closure of Dairy Innovation Australia Ltd (DIAL), which was the flagship body responsible for co-ordinating research across different universities. As manufacturing is more and more dominated by overseas companies, it is becoming clear that these companies are supported by offshore research. It also seems that Australian milk is being processed into relatively low value products, with more innovative higher value products being manufactured in the home countries (producing better returns for the home country farmers). Dairy Australia appears to have a shrinking research capacity, despite being generously funded by government as well as farmers for this function.

The increasing foreign ownership of Australia's dairy manufacturing plant runs the risk that Australian milk will be directed into products with relatively low value (such as milk powder) so that milk from the home countries of these companies can be sold for maximum value-add. There are already signs of this happening. This would mean that any indexing of the Australian farmgate price to global prices would be pitched to the lower vale commodities.

The Australian Government should be concerned about both repackaging of imported products and focusing Australian manufacturing on low value products, as this results in a considerable loss of tax revenue in the short term. Its longer term revenue impacts will be even more severe as Australia's production capacity shrinks. It should be noted that Australia's export capacity is dwindling faster than national milk production, as a higher proportion of milk is directed into the domestic market, and imports are increasing. Australia could become a net importer very soon unless falling milk production is reversed.

A7 Contracting practices

The report rightly identifies a number of contracting practices which appear to be unfair to farmers. There are some additional provisions which warrant consideration.

Provisions which penalise farmers for supplying less than a forecast volume are harsh in a situation of price fluctuations. In last year's clawback many farmers had to sell cows in order to survive, and were then hit with penalties for reduced milk supply. Even worse was the situation for farmers affected by prolonged flooding, as floods prevented the collection of their milk even when it was in the vats awaiting collection. Not only did they receive no payment for their milk because the processors were unable to collect it, but some were also hit with additional penalties because the volume if milk collected fell below the targeted volumes. (Note that some but not all contracts have provisions that impose these penalties even in the event of natural disasters.)

A further contract provision requires a minimum percentage of the total milk supplied (commonly over 40%) to be produced outside the peak season, to encourage flatter production. This can mean that advantageous spring conditions which unexpectedly increase milk volumes can tip the balance of supply, and result in heavy penalties. It has been reported that this can result in the price being paid for a seasonal milk flush being as little as 5 cents per litre after all price adjustments. This provides an argument for non-exclusive contracts, so that farmers have the option of selling this milk elsewhere at these times, for example to small dairy manufacturers who currently buy milk off the major processors at premium prices even in these peak times.

There is a need for improved transparency of the way that milk collected off-farm is handled, and how this impacts on the price that farmers received. For example there is increasing mistrust about how cell count analysis is carried out, as this can result in reductions in payment to farmers. Farmers commonly do their own testing before milk leaves the farm and this does not necessarily agree with the results announced by processors.

A8 Collective bargaining, boycotts and co-operatives

We would like to see retention of the possibilities for collective bargaining and supply boycotts, even if these are not much used at present. The industry is in a state of flux, and farmers need these options. There is continuing interest in co-operative structures and any measures that make it easier to form co-operative would be helpful. However some of the co-operative structures being proposed by the larger processors which involve non-votable shares appear to be highly questionable, and merely an excuse for revenue raising at the farmers' expense. There are some suggestions that these should not be allowed.

A9 Potential responses to identified issues

We would urge that whatever response the ACCC is prepared to make to the problems of the industry, this should be co-ordinated with other industry reforms. We have attached as a separate file the Dairy Industry Recovery Plan that Farmer Power has prepared, which may assist in providing a broad context for ACCC intervention.

A current example of the opportunities for a co-ordinated response is the proposed mandatory code of conduct, the acknowledged need to simplify milk supply contracts, and the preparation of a new milk price index. These initiatives could be dovetailed for maximum effectiveness. We would suggest:

- a milk supply contract template should be included in the mandatory code of conduct, ensuring some consistency in the variables that contribute to milk pricing for individual farmers, and

- pricing offers made by processors should explain not only how the price has been set (accounting for domestic and global dairy trends) but also how these same on-farm variables will impact on what individual farmers are actually paid, and

- the milk price index should be configured not only as a benchmark index against domestic and global trends (as specified in the milk price offer) but also as a comparison website within which the farmer can enter farm/management characteristics against these same variables to assess against the offer made by different processors.

Farmer Power would be happy to contribute to the design of the contract template and the comparison website, to ensure this really does result in transparency of pricing for farmers (as opposed to comparing apples with pears as at present).

B. Suggestions on the issues being further considered by the ACCC

B1 The most appropriate body to establish a dispute resolution framework

We do not a have a definite view on this, so long as it is clearly removed from inappropriate influence by processors. We do not consider that Dairy Australia or the Australian Dairy Farmers would be trusted by farmers in this regard. We believe that ACCC administration would be acceptable to farmers. An important consideration would be the cost of access to the dispute resolution process, as in any dependence on legal processes there would be an unfair contest between cash strapped farmers and the large corporations.

B2 The concept and format of a mandatory industry code

We agree that a mandatory code of conduct for this industry is essential, given the extent of poor past practices. Farmer Power would welcome the opportunity to contribute to its design.

B3 Pricing of milkfat

We quote from the published letter from dairy farmer Alex McKenzie to the UDV on this matter.

"In the late 1980s the dairy industry changed its payment system from fat to fat-plus-protein-less-volume. This was to pay farmers for the value of what they produced. In July 2000 with deregulation, farmers were informed they now had to farm to the world market.

"Over a number of years we have seen the fat-to-protein ratio change so that today the fat value on the world market is 273% more than that of protein. Today processors pay between 200 and 250% more for protein than for fat.

"This means a high fat producing herd of about 250 cows is having $50,000 per year or more transferred from their milk cheque over to the low fat producing herds. This can only be described as white collar crime or theft on the part of the processors, supported by the UDV and the ADF. It is now reported that over 40% of the sale of fat goes to subsidise protein."

We note that this price distortion is only one of many factors which works to the disadvantage of smaller scale farmers, many of whose herds are from breeds producing higher fat-to-protein ratios.

B4 Impact of exclusive supply clauses on small processors
As noted above, we favour a situation where farmers are able to sell their milk to whoever they please if it is surplus to the processor's requirements and they are being effectively penalised for overproduction. However in other circumstances there may be comfort for farmers in knowing that a processor will collect all of their milk.

B5 Application of UCT laws to dairy farming supplier agreements
We have previously raised concerns about the position of dairy farmers being in a "grey area" which may make it impossible to take legal action against large companies with deep pockets to pay for legal services. At present it would appear that the way milk supply contract are configured, and the financial transactions involved, could place many farmers outside the scope of protection against unfair contract terms. We would ask that the appropriate amendments be made to extend this protection, particularly in view of the unfair contract practices that are currently evident.

B6 Practicality of milk supply boycotts
See comments under A8 above. However we believe a boycott may be problematic in Victoria due to past legislation that defined milk production as an "essential service".

APPENDIX: THE DOLLAR MILK STORY

$1 milk was introduced by Coles in 2011.

In 2012 ADF President Chris Griffin stated that "*Increased sales of home brand milk, which have little or no margin for processors, have impacted on the value chain across Australia.*

"Coles must understand that the price on their shelves is linked to what farmers ultimately get paid," said Mr Griffin. "It is time Coles and Woolworths raised prices to a sustainable level and stopped their marketing tactic. Consumers can help dairy farmers and their families by buying branded milk, which provides a fairer return," said Mr Griffin.

This latest evidence of the unsustainable pricing of home brand fresh milk products highlights the need for a Supermarket Ombudsman to balance the market power of the major retailers. The Supermarket Ombudsman needs to have the power to investigate the supermarkets and use both 'name and shame' powers and financial penalties to ensure they treat suppliers and farmers fairly. ADF is meeting with politician's from all sides of politics to push the Supermarket Ombudsman and changes to the Competition and Consumer Act to provide some balance and fairness in the system.

A senate Inquiry into the impact of dollar milk was carried out in 2011, as Coles launched its discounts. The Australian Dairy Industry Council provided a detailed submission to the Senate Committee, and found that "*Coles must raise their process to a sustainable level if the industry is to remain viable in the main drinking milk production regions*." ADIC pointed out that branded milk sales would suffer, margins would be reduced, and farmers would see an immediate reduction in their milk cheques. ADIC also cast doubt on the claims made by Coles that it would bear the cost of margin reductions in its own homebrand sales. In conclusion it urged Government intervention because:

"If the reduced pricing structures persist they threaten to permanently strip many millions of dollars of value from the Australian supply chain for drinking milk, a chain that accounts for 25percentof national milk production and is the mainstay of the dairy industry in Queensland, Western Australia and Northern New South Wales."

By contract, Coles claimed that the introduction of dollar milk would benefit farmers because it would result in increased milk consumption. Over the five years to 2016 population growth was 7.9% but gross milk sales increased by only 7.6% (9.3% by volume). Because the introduction of $1 milk resulted in the price of competing name branded milk being lowered, the average price of milk fell by 1.6% over the same time that the consumer price index rose by 12.2%, resulting in a loss of revenue of $717M for processors and farmers.

By contrast, Dairy Australia apparently manipulated statistics to show that the industry had benefited by $325M over the same period, claiming that $1 milk had a positive impact for farmers. Analysis of the Dairy Australia statistics by the Financial Review (13 June 2016) indicated that sales revenue from higher priced flavoured milk had been included to achieve this result. It was also pointed out that Dairy Australia has not made any analysis of the impact of the sales figures on farmers. The Financial Review declared Dairy Australia's statistics to be defective and misleading, and suggested this was because of the improper influence that Coles and Murray Goulburn personnel had over Dairy Australia.

By 2016 the ADF and UDV had joined Dairy Australia and Coles in pushing the line that $1 milk has negligible impact on the farmgate milk price, as evidenced by ADF media releases and the UDV submission to last year's Senate Dairy Inquiry.

In 2014 a new 10 year contract for homebrand milk between Murray Goulburn and Coles reportedly shaved another 10% off the return to processors, which was already at negligible levels. It was reported that the negotiations involved trading off price against access to supermarket shelf space for name branded Devondale products (Financial Review 10.2.14). If the pricing of dollar milk continue through to 2014, this could represent a 50% price reduction in real terms since its introduction in 2007. As M-G failed to obtain its targeted sales volume for Devondale milk, it has been suggested that the falling margins for name branded milk contributed to its increasing debts, and ultimately the clawback on the farmgate milk price in 2016.

In 2016 Deputy Prime Minister Barnaby Joyce declared he was in favour of putting a stop to $1 milk. Some processors and independent retailers also argued against it in submissions to the ACCC Inquiry. Media coverage of the crisis in the dairy industry encouraged consumers to support dairy farmers by switching their purchasing towards name branded milk, putting around $100M back into the supply chain. Unfortunately this did not work as well as intended because (a) initially the supermarkets refused to restock the name branded product, (b) the processors responsible for name branded product didn't pass any of their windfall on to the farmers with the excuse that they didn't know how long it would last, and (c) the major supermarkets subsequently changed the labelling of their homebrand product to confuse the public about what they were buying. On this basis industry experts predicted that purchasing patterns would revert back to wards $1 milk. However this has not occurred.

Also in 2016 a Murray Goulburn spokesperson admitted that the price paid to processors for homebrand milk supply was the main determinant of the farmgate milk price. This was because the predictions made by ADIC in 2011 had come to fruition, with a steady decline in milk production as farmers quit or were forced out of the industry. The proportion of milk going into the domestic market had grown to 75%. Whereas before deregulation the domestic price of milk was a buffer against fluctuating global prices, generally offering a premium, the situation had changed to one where the low domestic price was pushing down the farmgate milk price for all farmers.

When the ACCC embarked on the current inquiry by convening meetings of farmers, they recorded that "*the overwhelming main issue raised by farmers from most states was the supermarket duopoly domination and generic store brands of $1 milk. It was clear to anyone in the room that the main market wrecker remains $1 milk and it has never been more vital to urgently address*." We would assert that these are the views of those in the industry who are best placed to make this judgement.

Even some of those who have dismissed claims about the actual negative impact of dollar milk on the industry (eg UDV, Bega Cheese) have admitted that it sends the wrong signals about the real value of milk, when it is priced significantly cheaper than drinking water. However an argument has been mounted that maintaining access to cheap milk is essential for the nutrition of low income families. This is a fallacious argument. It would be reasonable to price skim milk, possibly with added permeate, at $1 per litre and to label this accordingly, without taking money out of the value chain. This would be a product with all the nutritional value of whole milk but without the milkfat (which is currently priced higher than protein).

In late 2016 the VFF and Coles sought to capitalise on the surge of consumer support for dairy farmers by launching a new milk brand that promised to return an extra 20c per litre to farmers. On closer inspection it appeared that the VFF was a major financial beneficiary, and the financial benefits to farmers would be by way of grants rather than payment for product. The UDV membership was outraged by this. Dairy industry commentator Maid Marian offered the following scathing assessment.

"*The Coles Farmers' Fund is perfect material for a stand-up comedian really.*
Step 1. Using your massive market power, you send the price of milk down, down, down and dismiss the pleadings of farmers as ignorance.
Step 2. Next, you secure a 10-year deal with MG to source cheap milk while saying it's a great deal for farmers.
Step 3. When history brings MG's credibility to its knees and farmers down with it, consumers fall out of love with cheap milk and Coles. So what do you do?:
a) respond by restoring the price of milk to sustainable levels; OR
b) maintain the discount on milk and begin a "Down, down…" campaign targeting cheese as well; OR
c) come up with a farmer-endorsed PR stunt that costs you nothing but wins you back sales lost to branded products?
Well, bless you Coles. Presented with the easy option of permanently fixing the problem you created with solution a) you've instead gone with a devilish combination of b) and c)."

Footnote: But this may not have worked out as intended. After the initial awarding of $1M in grants of up to $20,000 each, the latest quarterly round was around $150,000 in grants of up to $10,000 each. Of course there is no transparency about how much the farmers are receiving, so it seems that either milk sales haven't reached expectations or the VFF is pocketing more that it should.

AUSTRALIAN DAIRY INDUSTRY RECOVERY PLAN

December 2017

Foreword

The context for the preparation of this Plan is an Australian dairy industry at the tipping point. A crisis has been building since 2013 which led to a collapse of milk production and factory closures in late 2016, and an ongoing decline which could lead to complete destruction of the industry. There are 45,000 jobs at risk, and the impact of job losses is already threatening the viability of many rural towns. Australian consumers stand to lose their access to fresh drinking milk as well as locally made dairy products, and Australia will lose what was once a major export industry.

Reversing this decline will take a concerted effort by all those involved in the dairy industry. This is no longer a time for laying blame for the crisis on any particular industry sector, it is a time for shared commitment to saving what remains of the industry, and rebuilding for the long term.

It is remarkable that there is no overall plan for the Australian dairy industry within governments or amongst the various industry bodies. Farmer Power has decided to fill this gap and has worked with award winning planning consultancy FOCUS to develop this plan.

There is no time to lose. We hope we can quickly build a framework that can be put into effect through shared effort. This will be based on the significant consultation and inquiries that have been carried out over the past year, which form an important foundation for this Plan.

The Plan has been prepared in two parts. Part One provides a summary of issues under the headings of Milk Production, Dairy Processing, Domestic Marketing, Export Marketing, Research & Development, Capacity Building & Advocacy. Objectives and Strategies are identified under each of these headings. Part Two provides an implementation framework for the Plan, identifying who is responsible for implementing each strategy, appropriate resources and targets.

Developing the Plan should be ongoing, so that as progress is made in industry recovery the strategies can be adjusted for best results. Quarterly reporting is appropriate.

Please join with us in committing to this plan for industry recovery.

Chris Gleeson, President

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VISION AND OBJECTIVES

The vision for this Recovery Plan is the establishment of a sustainable Australian dairy industry within which the profits of one sector are not made at the expense of another, and trust is established between all participants across sectors. This can provide the foundation for Australia to grow its milk production, maximise its product value, grow its exports and ensure its long term domestic food security.

The Plan's objectives are as follows.

Milk Production

- Stem the flow of existing farmers out of the industry.
- Provide a financial and operational basis for dairy farmers to build their herds and increase milk production.
- Provide incentives for young farmers to become involved in dairy farming.

Dairy Processing

- Encourage processors to co-operate in building the capacity of the Australian dairy industry.
- Enforce fair practices that are necessary to achieve sustainability of the industry.

Domestic Marketing

- Ensure Australia's food security through domestic dairy production.
- Provide conditions that enable dairy farmers and Australian dairy manufacturers to operate in different parts of Australia, catering for regional markets.
- Ensure that Australian dairy consumers have the information they need to choose the dairy products they want.

Export Marketing

- Restore Australia's competitiveness as a dairy exporter.
- Support Australian exporters seeking new markets.

Research and Development

- Establish an Australian dairy research capacity that supports innovation and product development.
- Improve the accuracy and timeliness of reporting on the dairy Industry to governments and other stakeholders.
- Provide extension services and training in the most cost effective way.

Capacity Building and Advocacy

- Establish an effective advocacy structure that provides good value for money for farmers and other industry participants.
- Rationalise food safety regulatory functions on a nationally consistent basis.
- Ensure that the advocacy structures are responsive to the needs of their client base.

1. MILK PRODUCTION

Situation Analysis

National milk production has dropped by around one third since deregulation in 2001. New Zealand has also deregulated its industry, but its milk production has doubled over the same period, suggesting that the New Zealand post-deregulation strategies have been much more successful.

The number of dairy farmers has more than halved since deregulation. This has resulted in some farm amalgamations, but it is difficult to tell whether this is a welcome trend or one that has been a result of smaller farmers being forced out of the industry. The emergence of corporate farms has had mixed results, with many of these proving unworkable in times of low milk prices. The vast majority of dairy farms are still family run.

Young entrants to dairy farming often lease their farms in the first instance, but buy their own herds and equipment. Unfortunately these people have suffered most from the recent industry downturn, as they have carried heavy debts but have had no equity in land to use as security for loan finance. Encouraging young people back into the industry will require much effort to build confidence. However this is essential if the industry is to continue, as the current farming population is ageing. As profit margins have fallen into negative figures, farmers have had to pay off workers, and many are working long hours in maintaining their farms. This is placing severe physical and mental stress on an ageing cohort.

Average farm debt has grown to around $1M. The value of dairy farms has fallen, so that many farmers face the prospect of farm repossession by their financial institutions. This situation is exacerbated by the fact that over 2016-17 farmers have had to sell off cows (for export or for beef) in order to pay their bills, leaving them with lower cash flow and limited capacity to repay loans into the future. The poor balance sheet has also limited the ability of dairy farmers to access government concessional loans which have been offered to some farmers to cushion them through the crisis.

The farm gate milk price has fallen well below the average cost of production, and this makes dairy farming unsustainable, and rising debt levels further increase the cost of production. There is no possibility of rebuilding the national herd unless the price farmers receive is increased. However price alone will not be sufficient to give farmers the confidence to rebuild their herds, and there needs to be a reform of the contractual practices that are in place. Currently these are heavily weighted in favour of processors' interests, and they do not give sufficient protection to farmers. The recently launched voluntary Code of Practice that has been prepared by processors has done little to rectify this situation. The very complex arrangements in place make it very difficult for farmers to negotiate on price, and to be clear about what price they will receive if they sign a particular contract. It is clear that price premiums are paid to some farmers but not to others, for reasons which are not always readily apparent. Current pricing attributes different values to fat and protein which do not align with market value, to the detriment of the farm gate price, and better benchmarking to both export and domestic values is required.

Rebuilding the national herd will take time, as herd culling has now extended to young heifers which would have been future milkers. Falling fertility rates and years of contracting production are factors to be considered. Pursuing increasing milk yield per cow (as has been encouraged in the past) may no longer be appropriate if this increases cash inputs and limits cows' productive life.

Objectives

1(a) Stem the flow of existing farmers out of the industry.

1(b) Provide a financial and operational basis for dairy farmers to build their herds and increase milk production.

1(c) Provide incentives for young farmers to become involved in dairy farming.

1.1 Securing Land and Water Resources

Strategy 1.1.1 Ensure affordable water access for dairy farming regions that are dependent on irrigation. *(implementation responsibility = water authorities, government agencies)*

Strategy 1.1.2 Rehabilitate abandoned dairy land for future dairying use.
(implementation = government grant agencies)

1.2 Building the National Herd

Strategy 1.2.1 Introduce tax incentives for herd expansion eg use of sex semen.
(implementation responsibility = Federal Government via ATO)

Strategy 1.2.2 Recognise a diversity of management models that can cater for different environmental conditions and product types to meet consumer demands.
(implementation = dairy industry bodies to recognise needs and opportunities for organic production, pasture fed production, flat production, intensive production, high protein, high fat, once a day milking, family farms, corporate farms, small and large farms etc.)

1.3 Operational Recovery

Strategy 1.3.1 Provide financial support for dairy farmers to upgrade their technology including production equipment, water supply systems and power generation to future proof their operations. *(implementation = government and private financial institutions, redirection of Federal Government budget already allocated)*

Strategy 1.3.2 Provide incentives for dairy farmers to rehire farm workers and/or expand the farm workforce.
(implementation = prioritise through existing State Government grant programs)

Strategy 1.3.3 Freeze dairy farm repossessions for a two year period, while dairy farmers recover.
(implementation = banks and other creditors)

1.4 Negotiating Fair Supply Contracts

Strategy 1.4.1 Introduce a <u>mandatory</u> code of conduct with affordable and effective enforcement provisions.
(implementation = ACCC)

Strategy 1.4.2 Enable collective bargaining through new and existing structures.
(implementation = ACCC and processors)

1.5 Achieving a Viable Price

Strategy 1.5.1 Simplify milk pricing and make it transparent, with a common timing for price announcements by processors and a standard contract pricing template.
(implementation = processors to implement through mandatory code of conduct)

Strategy 1.5.2 Provide a price insurance scheme that is funded through a levy on dairy product sales, so that farmers are able to draw on this when the farm gate price falls below cost of production.
(implementation = designed by Task Force formed from dairy industry bodies working with processors and retailers)

1.6 Strategies for Succession Planning

Strategy 1.6.1 Provide low interest loans to young people wanting to become dairy farmers.
(implementation = government incentives, possible draw down from insurance scheme in 1.5.2 or redirection of Federal Government budget already allocated)

2. DAIRY PROCESSING

Situation Analysis

The Australian dairy industry started out as a series of local co-operatives, in which the processing factories were owned by local dairy farmers, and profits were shared. Tensions arose early on, with farmers claiming they were being underpaid, and a Dairy Farmers Union functioned for a while to facilitate collective bargaining. This disappeared as the Australian industry became corporatised, but exploitation of farmers was moderated by regulation. The industry was then deregulated around 2000-2001, with protective measures being progressively phased up to 2007.

The trend to corporatisation has continued, with NORCO in Northern New South Wales remaining as the only true co-operative structure. Murray Goulburn has retained a mixed model. Most other large processors are now foreign owned, with complex shareholder structures operating between companies. Corporatisation may have resulted in prioritising the demands of non-farmer shareholders above those of supplier-farmers, which runs the danger of placing short term profits above long term sustainability.

Australian companies appear to have fallen well behind those of their international competitors in terms of value adding and innovation. It has been suggested that foreign owned companies tend to make lower value products in Australia and higher value products in their home countries. These companies conduct their product innovation overseas, so that cutting edge products are not produced in Australia. At the same time Australia's overall research and development capacity has dropped, partly as a result of processing companies declining to provide funding or to share information. This has severely reduced the capacity for home grown innovation.

The recent fall in milk supply has had an alarming impact on milk processing. It might have been expected (in a rational market) that shrinking supply would lead to an improvement in farm gate milk prices, so that this would encourage farmers to produce more and correct the imbalance between supply and demand. This has not occurred because the high debt levels of processing companies has discouraged them from paying more for supplies. The result of shrinking supply has been that expensive plant is often operating below capacity, further limiting their capacity to pay. At the same time there is fierce competition between processors (some operating in blocks) to tie up long term supply contracts with farmers in a way that disadvantages competitors. The impending collapse of some processing companies may be seen as a commercial opportunity by others, even though this damages the industry as a whole.

Current farm gate milk pricing includes a notional amount for milk transport that probably exceeds the actual cost, especially if local supplied are secured. This creates an incentive for processors to secure supplies from the lowest production areas, even if the transport costs would otherwise be prohibitive. Farmers are effectively subsidising a system which will put higher production areas out of business.

The pattern emerging for Australia as a whole appears to follow that which has occurred in Western Australia over the last decade. WA used to have a successful dairy industry providing for the local domestic market and supporting significant exports. The soils and climate in south-west WA are very suitable for dairying, and there is the potential for dairy production to be a major export industry in that State. However large companies have sought to rationalise their operations and have withdrawn from WA, crippling the infrastructure for smaller local processors, and leading to a collapse of local milk production. Dairy products are now transported to WA at a cost which appears to be much higher than the cost of local production would be. A similar trend appears to be occurring in Queensland, which could see the collapse of the industry in that State. If taken to its local conclusion, the process of rationalisation could lead to total collapse of the Australian industry in favour of New Zealand, with the result that consumers pay more for dairy product and have limited access to fresh milk.

Dairy food safety is governed by Australia-New Zealand Standards but implementation is carried out at the State level, with variations that sometimes disadvantage Australian dairy farmers compared with their New Zealand counterparts. This fractured system is part funded by dairy farmers through a levy on the farm gate milk price. The levy is being steadily increased without any accountability or justification. This system should be streamlined to achieve consistency and cost savings.

Objectives

2(a) Encourage processors to co-operate in building the capacity of the Australian dairy industry.

2(b) Enforce fair practices that are necessary to achieve sustainability of the industry

2.1 Re-Establishing Trust with Farmers

Strategy 2.1.1 Processors should pay farmers for all milk that is collected and used in dairy factories within 14 days of milk collection, and should guarantee not to withhold any payments unless the milk fails to meet specified standards.
(implementation = through mandatory code of conduct)

Strategy 2.1.2 Processors should provide support to their suppliers for rebuilding their herds by way of incentives (eg subsidised herd expansion and pregnancy testing).
(implementation = voluntary effort by processors to demonstrate good faith)

Strategy 2.1.3 Processors who have provided loans to farmers in return for long term contractual obligations should cancel these restrictions.
(implementation = voluntary action by processors enforced by ACCC/ASIC as appropriate)

Strategy 2.1.4 Processors who have “clawed back” payments already made to farmers should restore these payments.
(implementation = Murray Goulburn and Fonterra Australia, enforced by ACCC/ASIC as appropriate)

Strategy 2.1.5 Establish a national dairy food safety function to replace separate State bodies, to be administered in a way that protects farmers’ interests.
(implementation = Federal and State governments through a new dairy industry services body, see 6.2.1)

2.2 Maximising Added Value

Strategy 2.2.1 Foreign owned companies should commit to maximising the value of product they process in Australia, along the value chain.
(implementation = voluntary by processors, reporting by industry services body

2.3 Investment for the Long Term

Strategy 2.3.1 Processors should work with their investors to ensure a long term investment perspective, and to suspend expectations of short term profits while the industry rebuilds.
(implementation = industry services body to provide an outlook summary that can be included in reports to shareholders, including realistic expectations for recovery of milk supply and requirements for support to be given to farmer suppliers)

2.4 Innovation through the Supply Chain

Strategy 2.4.1 Processors should be encouraged to innovate, making best use of research findings within Australia and overseas.
(implementation = Federal and State Government incentives, greater commitment by processors, reporting by industry services body)

2.5 Negotiating Fair Sales Contracts

Strategy 2.5.1 The practice of retailers negotiating contracts for supply of heavily discounted product in return for shelf space should cease.
(implementation = ACCC enforcement with strengthened powers and penalties given by Federal Government, commitment by processors and retailers)

Strategy 2.5.2 Any negotiated contract for product sales should include commitment of the proportion of sales earnings that will be passed on to farmers.
(implementation = through mandatory code of conduct)

2.6 National Distribution

Strategy 2.6.1 The transport levy should be removed from the farm gate price, so that processors carry the actual cost of long haul milk.
(implementation = processors, enforcement by ACCC through a mandatory code of conduct)

Strategy 2.6.2 Farmers and small scale processors should not be put out of business as a result of withdrawal of infrastructure or sales outlets by major processors.
(implementation = the Queensland State Government to act promptly in the interest of their consumers and businesses, with local solutions to safeguard business viability)

Strategy 2.6.3 The Western Australian dairy industry should be rebuilt, to take advantage of its excellent natural resources, and in the interest of local consumers.
(WA State Government to develop a dairy industry rebuilding strategy)

3. DOMESTIC MARKETING

Situation Analysis

Milk produced from dairy farms in Western Australia, Northern New South Wales and Queensland is primarily directed into fresh drinking milk, with small quantities being provided to boutique manufacturers of cheese and yoghurt. Dairy farming is more expensive in these areas, but the extra payments made to farmers are offset by their proximity to the markets. In Victoria, South Australia and Tasmania a majority of milk is used in manufacturing for both the domestic and export markets. In the Northern Territory there is no dairying from cows, and fresh drinking milk is transported from elsewhere.

Dairy farming outside the main areas of production in southern Australia suffers not only from higher production costs but also from lower critical mass. Western Australia has steadily lost most of its dairy production as the large corporate processors have consolidated their operations and pulled out. Dairy produce is now being transported long distances to Western Australia at considerable cost. A similar process now threatens Queensland's remaining dairy farmers.

Pricing of milk varies across brands, but is similar across States despite the different transport costs involved in reaching consumers. Since 2007, major supermarkets have marketed heavily discounted "dollar milk" as a way of attracting customers. However unlike discounted fuel (which is used similarly as a marketing gimmick to attract customers) the supermarkets do not compensate suppliers for the discounted price. Instead, it appears that processors are persuaded to provide homebrand drinking milk at an increasingly cheap price in return for securing shelf space for their name branded dairy produce (milk and other goods). It has been calculated that processors are unable to recover their production costs from discounted milk, and they are unable to pay farmers a price that adequately covers the cost of production.

Some processors have willingly signed contracts with the major supermarkets on the basis that this gives a long term dependable market that enables them to build supply. However such contracts have often been broken in recent years, and the keen competition for a shrinking national milk supply may make this strategy inappropriate.

Discounted milk is acknowledged as a "loss leader", meaning that it is sold at a price below its market cost to stimulate other sales of more profitable goods. In the case of milk, it reduces the earnings of processors and farmers not only because of direct discounting, but also because the prices of name branded products have to be reduced to compete with the homebrand product. The Minister for Agriculture has indicated he will be looking to the Australian Competition and Consumer Commission (ACCC) to recommend what measures are appropriate to address this situation in a report that will be concluded in November 2017. However it is necessary to develop interim strategies as a matter of urgency.

Pricing of cheese and yoghurt is suppressed not only by competition with discounted homebrand product, but also more recently with bargain priced imports which could constitute dumping. When products are priced below the retail price in the country of origin, the Australian Government can impose a dumping tax. However the process for initiating, researching and implementing this action is unclear. Consumer demand for Australian product is high, but labelling of product does not always inform consumers clearly about country of origin, and this continues under intended future labelling requirements.

There is increasing demand for organic dairy products, so that farmers are now being offered significant premiums for converting their farm operations. This trend is likely to continue as a niche component of the domestic market, with participation by smaller farms.

As most Australian production is from pasture fed cows, there is not yet the sort of price differentiation made overseas between milk from pasture and stall fed operations. However as there are plans to expand stall feeding in future, this needs to be considered in terms of its impact on the industry, product pricing and consumer choice.

Dairy Australia's domestic marketing using the "Legendairy" theme has been remarkably unsuccessful, and should be replaced by a much better targeted campaign, that appeals to discerning consumers.

Objectives

3(a) Ensure Australia's food security through domestic dairy production.

3(b) Provide conditions that enable dairy farmers and Australian dairy manufacturers to operate in different parts of Australia, catering for regional markets.

3(c) Ensure that Australian dairy consumers have the information they need to choose the dairy products they want.

3.1 Retailing Networks and Markets

Strategy 3.1.1 Retain regional supply capacity in the interests of national milk production and regional food security.
(implementation = processors by mutual agreement, to be addressed in the mandatory code of conduct and encouraged by State governments)

Strategy 3.1.2 Re-establish production capacity in Western Australia through incentives for start up processing.
(implementation = WA State Government)

3.2 Sustainable Fresh Milk Pricing

Strategy 3.2.1 Price fresh milk in store at a level which provides a sustainable return to retailers, processors and farmers.
(implementation = retailers to implement, encouragement by consumers, long term action by ACCC – see also Strategy 6.4.6 for proposed price levy)

3.3 Competitive Dairy Product Pricing

Strategy 3.3.1 Establish vigilant surveillance to identify imported dairy product dumping, with prompt follow up action.
(implementation = dairy industry services body, follow up action protocols with Federal Government)

Strategy 3.3.2 Maintain a watching brief to ensure that dairy products other than fresh milk do not become the new "loss leaders".
(implementation = ACCC with enhanced enforcement capacity)

3.4 Informative Product Labelling

Strategy 3.4.1 Enhance product labelling in the short and long term to clearly identify country of origin, as well as guaranteed returns to farmers.
(implementation = Federal Government legislation based on proposed Queensland model, processors to comply, strict monitoring and enforcement)

Strategy 3.4.2 Require processors to clearly distinguish between reconstituted milk and fresh milk for retail sales.
(implementation = Federal Government legislation complemented by community education)

3.5 Changing Consumer Demand

Strategy 3.5.1 Monitor and project changing consumer demand and associated earnings from different production regimes, including fat/protein values, organic and pasture fed premiums.
(implementation = dairy industry services body in collecting and disseminating information)

3.6 Effective Promotion and Marketing

Strategy 3.6.1 Replace the Legendairy campaign with targeted information on dairy nutritional value, the need to support Australian producers, and how to scrutinise labelling.
(implementation = dairy industry services body)

Strategy 3.6.2 Introduce school milk programs together with family education about nutritional value.
(implementation = State governments)

4. EXPORT MARKETING

Situation Analysis

Global trade in dairy products is equivalent to around 30B litres, or less than 10% of total global production. Around 35% of this is exported from New Zealand, and the other significant contributors are the USA, Canada and the EU. Brazil and Argentina are also growing as exporters. Australia is falling well behind as its production plummets.

Ten years ago Australia and New Zealand produced equivalent quantities of milk, but Australia's dwindling supply (and New Zealand's expansion) has resulted in Australia losing ground as an exporter. Exports have fallen from around 60% of national dairy production ten years ago to around 25% in 2017, largely because of falling milk production. Australia's cheese exports have dropped significantly, severely impeding overall export performance. American dairy produce has tended to fill the gaps left by Australia as its own exports have grown.

Over 70% of Australian exports go into the Asian market, the largest now being China. Japan has been the major export destination in the past, but this market is unlikely to demonstrate significant future expansion despite the removal of tariffs as a result of a recent Free Trade Agreement (FTA). FTAs with Malaysia, South Korea and China offer better prospects, though Fonterra NZ has positioned itself well within the Chinese market. Current negotiations to open up the Indonesian market may offer Australia particular competitive advantage.

Over the past five years, Australian exporters appear to have misjudged the Asian market, investing heavily in making a switch from cheese production to manufacture of infant formula. While this had good prospects initially, the unpredictable and changing regulatory frameworks which differ between Asian countries have created considerable problems. At the same time, production of all milk powders has suffered from a global glut, with unsold stockpiles still evident in Australia. A downturn in global prices is attributed to a lifting of production quotas in the EU and a trade sanctions with Russia, and this has exacerbated difficulties for Australian exporters.

Australia's location and its relatively low cost production places it in an excellent position to export dairy products to Asian markets. However the characteristics of these markets varies considerably, as does Australia's competitive advantage in relation to these markets.

A further difficulty facing Australian exporters is that many of its international competitors receive subsidies for farm production of milk, sometimes amounting to 50% of production costs. The exception is New Zealand, where production is so well geared to export that its farmers receive other advantages. A further disadvantage for Australian processors is that Australia tends to regard the global trading protocols as mandatory, whereas its competitors regards them as guidelines which can be circumvented.

If Australia is to regain its role as a dairy export nation then it will need to find new ways to support its dairy farmers through periods of low global dairy prices, as well as providing support for its processors in accessing profitable markets.

New Zealand promotes its clean green pasture fed dairy products on the export market. Australia can boast a similar quality of produce but there is no comparable national marketing effort.

Objectives

4(a) Restore Australia's competitiveness as a dairy exporter.

4(b) Support Australian exporters seeking new markets.

4.1Effective International Competition

Strategy 4.1.1 Ensure that Australian export processors and their suppliers are not disadvantaged by unnecessary adherence to guidelines that are ignored by Australia's competitors, recognising also that milk supply is an essential commodity that is exempted from some WTA/FTA requirements.
(implementation = dairy services body to advise Federal Government before and after execution of FTAs)

Strategy 4.1.2 Ensure that Australia's dairy industry is not disadvantaged in Free Trade Agreements as part of negotiating for other benefits.
(implementation = Federal Government)

4.2 Meeting International Demand

Strategy 4.2.1 Prepare an annual Dairy Export Strategy that can advise exporters on the characteristics of different export markets, including consumer demand, regulatory requirements and risks.
(implementation = AUSTRADE)

Strategy 4.2.2 Prioritise assistance to dairy processors, including start up companies, based on likely fit with emerging export demand.
(implementation = Federal and State governments)

4.3 Securing Access to Markets

Strategy 4.3.1 Prioritise access to dairy export markets in negotiation of new trading agreements, including current negotiations with Indonesia.
(implementation = Federal Government)

4.4 Improved Risk Management

Strategy 4.4.1 Where dairy product intended for export markets in good faith is subject to contract cancellation, purchase supplies for redirection through the foreign aid budget or domestic food charities.
(implementation = Federal Government, State Governments)

4.5 Transparent Benchmark Pricing

Strategy 4.5.1 Establish a clear benchmark pricing formula for milk supplied by farmers to manufacture export products.
(implementation = dairy processors, address in code of conduct)

4.6 Promoting the Australian Brand

Strategy 4.6.1 Establish new branding and promotion of export product that highlights Australia's clean green image and its production based on pasture fed herds.
(implementation = AUSTRADE)

Strategy 4.6.2 Increase promotion of dairy innovations through Trade Fairs and other international marketing events.
(implementation = AUSTRADE, State governments)

5. RESEARCH AND DEVELOPMENT

Situation Analysis

Australia's dairy research effort has virtually disappeared. Dairy Australia proclaims itself as an R&D organisation but it does not conduct original research, and its R&D function is limited to information collation and dissemination, with many questioning the value of this output. The previous dairy research section of the CSIRO has been disbanded, together with some combined research being pursued with universities (some of which had resulted in new processing proposals that were near ready for commercialisation, now abandoned). Australia's flagship research body, Dairy Innovation Australia Ltd (DIAL) was closed down last year, leaving a number of shared research projects with different universities in limbo. DIAL's funding came from Dairy Australia as well as some of the major processors, who stood to benefit from its research findings. However it appeared that these various companies were increasingly reluctant to pool their resources for joint research.

As processing becomes dominated by foreign owned dairy companies, these are able to benefit from significant overseas research carried out by the same companies. However to date the Australian arms of their operations do not appear to benefit from cutting edge technologies or product profiles.

If Australia is to restore its dairy industry as a significant employer and export earner, it needs to retain its own dairy research capacity. This can support innovation and enterprise growth on the part of Australian dairy companies, large and small. The Federal Government currently invests around $20M per annum on the R&D functions of Dairy Australia, and this could be much more effectively targeted at direct research.

Much of Dairy Australia's R&D allocation is expended on field extension services, focusing on pasture improvement and herd genetics for example. This work is the main function of the eight Research and Development Programs established throughout the dairy regions of Australia. However these are used by a minority of farmers, and the quality of these programs is questioned by those who prefer to choose their own service providers from the private sector, enabling them to select and pay for the services that are most appropriate to their needs. Farmers could be assisted in accessing these services through expansion of existing grant programs, potentially involving services to clusters of local farmers. This would reinvigorate service provision, ensuring that farmers have access to cutting edge innovations on farm.

There is much scope for innovation in Australia's dairy industry, but there are significant obstacles for start up entrepreneurs. Access to government grants and private sector venture capital seems to be easier for established foreign owned companies than for small Australian start up enterprises. Currently Australia's start up assistance is focused on tech companies. Australian financial institutions will generally not lend to companies without established cash flow and equity. As a result, innovations in manufacturing often depend on foreign investors, who are likely to become shareholders and influence priorities. This situation demands a reprioritisation to build on Australia's natural resources and the maximise value adding for the benefit of the Australian economy.

Objectives

5(a) Establish an Australian dairy research capacity that supports innovation and product development.

5(b) Improve the accuracy and timeliness of reporting on the dairy Industry to governments and other stakeholders.

5(c) Provide extension services and training in the most cost effective way.

5.1 Improved Research Capacity

Strategy 5.1.1 Redirect most of the Federal Government R&D funding from Dairy Australia into the CSIRO, with a revived dairy research unit that can work with and co-ordinate the research effort of Australian universities.
(implementation = $15M per annum research allocation by the Federal Government redirected to CSIRO)

Strategy 5.1.2 Redirect priorities for allocation of research grants by the Gardiner Foundation to projects which are of direct practical benefit to Victorian farming operations.
(implementation = $10M per annum for the next 3 years – see Strategy 6.1.2 below)

Strategy 5.1.3 Review the outcomes from dairy research every three years to ensure value for investment, and adjust forward priorities accordingly.
(implementation = Federal Government)

5.2 Monitoring Industry Dynamics

Strategy 5.2.1 Establish monitoring and reporting on the dairy industry as a core function of a new national industry services body, with a dedicated budget of $2M per annum to be provided by the Federal Government.
(implementation = Federal Government – see Strategy 6.2.1 below)

5.3 Disseminating Critical Information

Strategy 5.3.1 Establish a new protocol for the Australian Parliament to receive reports from the new industry services body rather than interpretative reports from public servants with limited skills in research, and a poor understanding of the dairy industry.
(implementation = Parliamentary Services reform)

5.4 Timely Advice to Governments

Strategy 5.4.1 For the next three years, the Australian Parliament and State Parliaments should receive and discuss quarterly reports from the new industry services body on the state of the Australian dairy industry and the progress in implementing this Recovery Plan.
(implementation = Parliamentary Services – note that this reporting can also address implementation of the various Government inquiries that have contributed to this Plan, ensuring that finding are translated into action)

5.5 Reconfiguring Extension Services

Strategy 5.5.1 Redirect farmers' field extension services to the private sector, with grant funding support for farmer clusters.
(implementation = Defund the RDPs at a cost saving of around $10M, and prioritise grants to farm clusters for the Gardiner Foundation in Victoria, other grant programs to be identified by State governments in other States)

5.6 Encouraging Innovation

Strategy 5.6.1 Prioritise dairy innovation in allocation of resources by governments and the private sector.
(implementation = Federal and State Governments to quarantine funding allocations for dairy innovation within existing grant and loan programs, and through underwriting risk for private lenders as an extension of EFIC functions)

Strategy 5.6.2 Extend eligibility for the R&D Tax Incentive to dairy farming family trusts.
(implementation = ATO)

6. CAPACITY BUILDING AND ADVOCACY

Situation Analysis

Dairy farmers have lost faith with the current representative structures, because of the lack of action to protect farmers' interests. This has created a vicious circle as farmers withdraw their membership, and falling revenues creates a funding gap that has to be filled through corporate sponsorship. Willing sponsors may be dairy processors and retailers, but this creates a perceived conflict of interest from the farmers' point of view, creating even more disillusionment.

Dairy Australia currently has no role in political advocacy, and its residual roles are poorly defined. As long as it relies on funding from dairy farmers there is will be questions raised as to why other industry sectors are heavily represented in its governance structure, and why its activities benefit these other sectors. It needs to establish much closer connection with its client base, and for this reason relocation to a regional centre is highly desirable (and will also save costs).

For an industry services body to be effective, there needs to be a complementary advocacy function for dairy farmers within the same organisation or separate from it. Australian Dairy Farmers (ADF) has this role at present, but it has weak and unstable leadership, and some potentially compromising sponsorship arrangements. Its advocacy voice has been ineffective in the present crisis, and there has been no evidence of policy or action.

The various State based advocacy structures vary in their effectiveness and their credibility with their client base. In Queensland, the Queensland Dairy Organisation appears to be highly effective and well respected by farmers. In Victoria the placing of the United Dairy Farmers of Victoria (UDV) under the umbrella of the Victorian Farmers Federation (VFF) has led to loss of autonomy and effectiveness.

Another structure intending to benefit dairy farmers has been the eight Regional Development Programs (RDPs) which are funded through Dairy Australia but which are separately incorporated. These engage with farmers in providing the type of extension services that were previously provided by State Governments (filling a gap when these services were withdrawn). However these services reach a minority of farmers, and it would be more equitable for these farmer to pay for their services rather than the majority of farmers subsidising their access. The type of extension services offered could readily be provided by the private sector on this basis.

Training for the dairy sector has collapsed, possibly as a result of fewer people entering the industry. There is a role for an industry services body to develop and accredit training courses, but these can be rolled out through the TAFE system or by private providers as demand rebuilds.

A new representative structure is required which avoids the trap of building bureaucracies and losing touch with the client base, and which does not drain farmers' earnings. This includes the funding of food safety compliance with the Australia-New Zealand Standard, which is currently administered separately in each State, with dairy farmers contributing an estimated 20% of the running costs through a levy on the farm gate milk price.

Objectives

6(a) Establish an effective advocacy structure that provides good value for money for farmers and other industry participants.

6(b) Rationalise food safety regulatory functions on a nationally consistent basis.

6(c) Ensure that the advocacy structures are responsive to the needs of their client base.

6.1 Building Industry Skills

Strategy 6.1.1 Provide a national system of training course development and accreditation that can be rolled out through public and private training providers.
(implementation = new national services body)

6.2 Industry Leadership and Representation

Strategy 6.2.1 Create a new national dairy industry services body, to be located in regional Victoria with the following functions:

- **Developing and accrediting training courses for farmers and farm workers**
- **Administering Dairy Food Safety on a national basis**
- **Collecting, assessing and disseminating information on dairy industry dynamics**
- **Advocating to government and others on behalf of industry sectors.**

The governance arrangements should provide for one vote per licensee.
(implementation = Federal Government and State governments to amend legislation and contractual structures, core funding limited to $2M per annum for reporting services to Government plus additional funding through licensing fees from all sectors, location at Glen Ormiston College if available or otherwise Geelong)

Strategy 6.2.2 Establish a separate national industry body representing dairy processors which excludes companies that are importers, to be funded by member subscription.
(implementation = existing industry bodies separating from the Dairy Australia governance structure)

Strategy 6.2.3 Farmers to form new independent representative structures (or adapt existing structures outside Victoria) within similar catchments to the current RDPs, funded by voluntary subscription.
(implementation = farmers, possible seed funding made available through grants from Dairy Australia reserves as this organisation is wound up)

6.3 Networking Industry Participants

Strategy 6.3.1 Secure funding to enable all dairy farmers to become better connected using email, Skype, social media and other Internet resources.
(implementation = regional industry bodies securing grant funding, Gardiner Foundation to fund in Victoria)

6.4 Mobilising Industry Resources

Strategy 6.4.1 Place Dairy Australia reserve funds in trust with the new industry services body for allocation in implementing this Recovery Plan.
(implementation = around $20M reallocated – some of this could be used to purchase Glen Ormiston College)

Strategy 6.4.2 Reprioritise distribution of Victorian funds from the Gardiner Foundation to implementing this Recovery Plan with a streamlined administrative structure.
(*implementation = Victorian Government to require a streamlined administrative structure with a budget of no more than 10% of funds allocated, annual allocation increased to $10M per annum for the next three years)*

Strategy 6.4.3 Redirect Federal and State Government grant programs to implementing this Recovery Plan.
(implementation = $500m reallocated by Federal Government, reprioritising employment and economic development programs by State Governments agreed by COAG to match Federal funding allocations, total pool $1B))

Strategy 6.4.4 Additional funding effort to be committed by processors in assisting their farmer suppliers.
(implementation = target contribution for purchasing new herd stock and subsidising pregnancy testing)

Strategy 6.4.5 Raise funds for an insurance/hedge pricing vehicle through a 50c levy on the retail price of drinking milk, to be invested with earnings to be deployed through grants, and with the possibility for farmers' incomes to be subsidised when the farm gate milk price falls below an agreed benchmark.
(implementation = Federal Government to revive existing legislative framework, new industry services body to administer)

6.5 Working Across Sectors

Strategy 6.5.1 Facilitate an inclusive national Dairy Conference to launch this Recovery Plan, with a subsequent annual conference to review progress in each State.
(implementation = Federal and State government support for the initial Conference as part of their implementation commitment, subsequent State governments funding support with organisation by the national industry services body)

6.6 Implementing the Recovery Plan

Strategy 6.6.1 Encourage progressive sign up of stakeholders to support this Plan, though Memoranda of Understanding.
(implementation = through sign up to the attached Implementation Framework)

IMPLEMENTATION RESPONSIBILITIES

Federal Government

Minister for Agriculture

Redirect $500M from existing Dairy Assistance package as follows.
1.2.1 $100M for subsidised importation of high quality dairy heifers (to be administered by dairy industry body)
1.3.1 $400M for a continued concessional loan program for farm improvements, with easier access and no repayments for first three years
6.2.1 Terminate contract with Dairy Australia as the national dairy industry service body
5.1.1 Redirect most of the Federal Government R&D funding from Dairy Australia into the CSIRO, with a revved dairy research unit that can work with and co-ordinate the research effort of Australian universities ($15M pa)

Whole of Government

4.1.1 Seek a level playing ground for processors in competing for export markets against its competitors through implementation of global trading agreements.
4.3.1 Prioritise access to dairy export markets in negotiation of new trading agreements, including current negotiations with Indonesia
4.2.2 and 5.6.1 Prioritise assistance to dairy processors, including start up companies, based on likely fit with emerging export demand and/or dairy product innovation, through existing industry assistance programs.
4.1.2 Ensure that Australia's dairy industry is not disadvantaged in Free Trade Agreements as part of negotiating for other benefits.

Parliamentary Services

5.3.1 and 5.41 Establish a new protocol for the Australian Parliament to receive reports directly from the new industry services body, quarterly for the next three years

AUSTRADE

4.2.1 Prepare an annual Dairy Export Strategy that can advise exporters on the characteristics of different export markets, including consumer demand, regulatory requirements and risks
4.6.1 Establish new branding and promotion of export product that highlights Australia's clean green image and its production based on pasture fed herds
4.6.2 Increase promotion of dairy innovations through Trade Fairs and other international marketing events

DFAT

4.4.1 Where dairy product intended for export markets in good faith is subject to contract cancellation, purchase supplies for redirection through the foreign aid budget

EFIC

Seek Government authority to underwrite risk for private lenders to start up export producers.

Parliamentary legislation

1.4.1 Mandatory code of conduct for the dairy industry on request of new industry services body, with improved enforcement procedures and more effective penalties for ACCC
3.3.1 Strengthen provisions for enforcement of anti-dumping legislation and collection of dumping tax by ACCC

1.5.2 Reactivation of the Dairy Industry Adjustment Program to provide for a 50c levy on the retail price of drinking milk to be collected by the industry services body by amendment to Dairy Produce Act, and placed into a Trust for benefit of dairy farmers (annual revenue $1.2B)
3.4.1 Enhance product labelling requirements with clearer and more prominent information on country of origin, and to include guaranteed returns to farmers on Australian product
6.2.1 Cancel contract with Dairy Australia on establishment of new industry services body, with funding contribution of $2M per annum to the new body for provision of information services

ACCC

1.4.1, 2.6.1 and 3.3.2 Enforce new mandatory code of conduct including maintaining a watching brief in compliance by all parties
1.4.2 Facilitate effective collective bargaining by dairy farmers and prevent blocking by processors
3.3.1 Promptly act on reports on import dumping by imposition of dumping tax, with proceeds allocated to ACCC budget

CSIRO

5.1.1 Re-establish dairy research unit that can work with and co-ordinate the research effort of Australian universities (Federal funding $15M pa)

All State Governments

1.1.1 Ensure affordable water access for dairy farming regions that are dependent on irrigation.
1.1.2 Provide incentives for rehabilitation of abandoned dairy land for future dairying use.
1.3.1 Simplify ease of access to Federal Government concessional loans, eg directing applications through a range of private institutions
1.3.2 Allocate a set portion of existing State grant programs for job creation to farmers for hiring/rehiring farm employees (50% grant funding for first two years' wages)
3.6.2 Introduce or enhance school milk programs together with family education about nutritional value
4.2.2 and 5.6.1 Prioritise assistance to dairy processors, including start up companies, based on likely fit with emerging export demand and/or dairy product innovation, through existing industry assistance programs
4.4.1 Where dairy product intended for export markets in good faith is subject to contract cancellation, purchase supplies for redirection through domestic food charities
6.3.1 Secure funding for communications technology and capacity building in its use to network all dairy farmers
6.4.3 Collectively (through COAG process) match Federal Government $500M commitment to rebuilding the industry through the above initiatives

Queensland Government

2.6.1 Negotiate with major processors for retention of milk collection and processing infrastructure in Queensland

Western Australian Government

2.6.2 and 3.1.2 Establish strategy for rebuilding dairy industry infrastructure and encouraging dairy processing start ups with a budgetary commitment for provision of appropriate incentives – suggested annual budget $10M based on potential 5:1 economic return on investment

Victorian Government

1.3.2 Target 400 jobs per annum to be created from the Regional Jobs Program over two years, at a total cost of $25M

5.1.2 Redirect priorities for allocation of research grants by the Gardiner Foundation to projects which are of direct practical benefit to Victorian farming operations ($10M pa for 3 years, admin costs not to exceed 10% of allocated funds)
6.3.1 Direct Gardiner Foundation to allocate 2M (10% of $10 annual grants) over 2 years as funding for communications technology and capacity building in its use to network dairy farmers

Private Sector Institutions

1.3.1 Participate in easing access to government grant programs (financial institutions)
1.3.3 Freeze dairy farm repossessions for two years (financial institutions)
1.6.1 Participate in provision of low interest loans to young people wanting to become dairy farmers (financial institutions)
5.6.1 Funding support for dairy innovation should be given priority in allocation of resources (financial institutions)
5.5.1 On-farm extensions services to be provided and funded on a fee for service basis (feed, pasture, genetics and business management companies)

Dairy Processors

Implementation on a voluntary basis as soon as possible, later to be included in code of conduct.
1.4.2 Commit to participation in collective bargaining where this is proposed by farmers
1.5.1 Provide simplified and transparent milk pricing system with common timing on price announcements
2.1.1 Reduce payment period to 14 days, with payment in full for all milk collected
2.1.2 Remove restrictions on dairy farmers changing their supply arrangements imposed as part of loan agreements
2.1.3 Provide subsidies for farmers expanding their herds and also for pregnancy testing
2.1.4 Reverse the "claw back" payment deductions imposed on farmers in 2016, and remove such provisions from milk supply contracts
2.3.1 Inform non-farmer investors that the current crisis necessitates a curtailing of short term dividends while the industry rebuilds
2.4.1 Commit to innovation, including a publicly announced funding commitment to dairy research and development in Australia
2.6.1 Remove the transport levy from the farm gate price, so that processors carry the actual cost of long haul milk
2.6.2 Cease withdrawal of infrastructure which prejudice the viable production of milk in Queensland and Western Australia
2.5.3 Remove the current transport levy on farmers so that processors pay for real transport costs of milk off farm (overall industry savings reflected in savings to farmers)
3.4.1 Develop product labelling that specifies viable returns to farmers
4.5.1 Establish a clear benchmark pricing formula for milk supplied by farmers to manufacture export products, in consultation with dairy industry services body
6.2.2 Establish a new national industry body representing dairy processors which excludes companies that are importers, to be funded by member subscription
Work with dairy farmers to include these provisions in a workable code of conduct

Foreign owned companies

2.2.1 Commit to maximising the value of product they process in Australia, with corresponding value calculations within the farm gate milk price

Dairy Retailers

2.5.1 Cease negotiating contracts for dairy products as "loss leaders", including negotiating on shelf space as a factor in product pricing

2.5.2 and 3.2.1 Include commitments to a viable return for dairy farmers in any product purchase negotiations, to be made public
Work with dairy farmers to include these provisions in a workable code of conduct

Dairy Farmers working with Dairy Industry Bodies

6.6.1 Seek the commitment of all industry participants to support implementation of the Recovery Plan through a Memorandum of Understanding that identifies their particular roles and responsibilities. This should include consulting dairy farmers and develop a workable code of conduct that can be implemented immediately on a voluntary basis, and then mandated through legislation (see potential provisions above)
6.5.1 Facilitate an inclusive national Dairy Conference to launch this Recovery Plan
1.5.2 and 6.4.5 Establish a Task Force to establish a price insurance scheme that is funded through a levy on dairy product sales
6.2.3 Disband existing structures and form a new independent dairy farmer representative structure (or adapt existing structures outside Victoria) within similar catchments to the current RDPs, funded by voluntary subscription
6.2.1 Create a new national services body for the industyry, to be located in regional Victoria (Glen Ormiston College preferred)
6.2.1 WInd up DA and RDPs, liquidate assets and reallocate reserves to new services body ($20M seed capital with allocations to support implementation this Recovery Plan – some could be allocated to purchase of Glen Ormiston College); abolish compulsory dairy levies, establish separate Chapters for dairy farmers, processors and retailers, with allocation of board members as follows: Dairy Farmers 5, processors 3, retailers 2. Board members to be voted on the basis of one vote per licenced business.

Dairy industry body to include the following responsibilities.

- 1.2.2, 6.2.1 and 3.5.1 Advocate for dairy farmers across a diversity of farm management models, production types and scales of operation (principle of operations) through the Dairy Farmers Chapter, and for other industry sectors through other Chapters
- 2.1.5 administer a national Dairy Food Safety framework that is consistent with the ANZ standards and which does not disadvantage farmers in their dealing with processors, to be funded through a new system of pricing for licences (farm, processors and retailers)
- 5.2.1 Establish monitoring and reporting on the dairy industry as a core function ($2M pa Federal funding)
- 3.3.1 Include monitoring and reporting on apparent import dumping to ACCC for action, and reporting on action
- 3.4.1 and 1.5.2 Monitor and report quarterly on benchmarks for determining minimum viable farm gate milk pricing
- 3.6.1 Domestic promotion of the nutritional value of Australian dairy products (subsidised by licence fees)
- 4.5.1 Establish a clear benchmark pricing formula for milk supplied by farmers to manufacture export products, in consultation with processors (included in above budget)
- 6.1.1 Provide a national system of training course development and accreditation that can be rolled out through public and private training providers (funded through licence fees)
- 6.5.1 Monitoring and reporting on implementation of this Recovery Plan, including annual conference to discuss progress (funded through licence fees)
- 6.4.5 Administer Trust for benefit of dairy farmers (1.5.2) that provides:
  - a superannuation scheme for dairy farmers that they can draw on in times of demonstrated financial hardship ($800M per annum)
  - a low interest loan scheme to assist new/young farmers in purchasing farms, stock and equipment ($200M per annum with no repayments for first two years)


ANTI-COMPETITIVE PRACTICES IN THE AUSTRALIAN DAIRY INDUSTRY
a presentation to the ACCC by Farmer Power

Passing on risks to the farmers

For example:

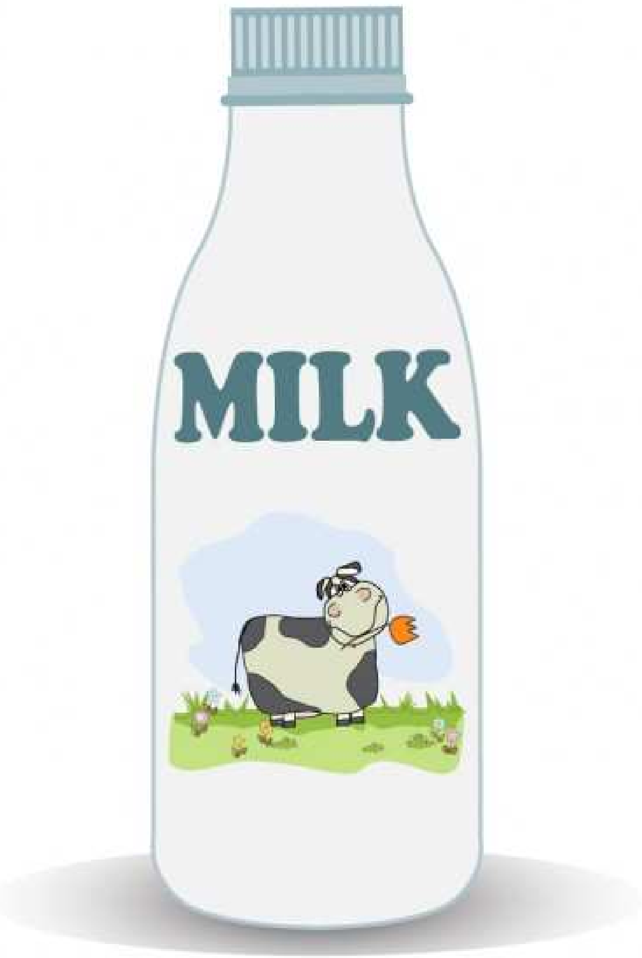
- **Passing on variations in global prices**
- **Passing on power price increases**
- **Penalising farmers affected by natural disasters**
- **Penalising farmers for a good spring**
- **No CPI for farmers**

  - processors protect shareholder dividends

  - factory workers get CPI

  - farm workers get CPI

  - farmers get paid less as a result



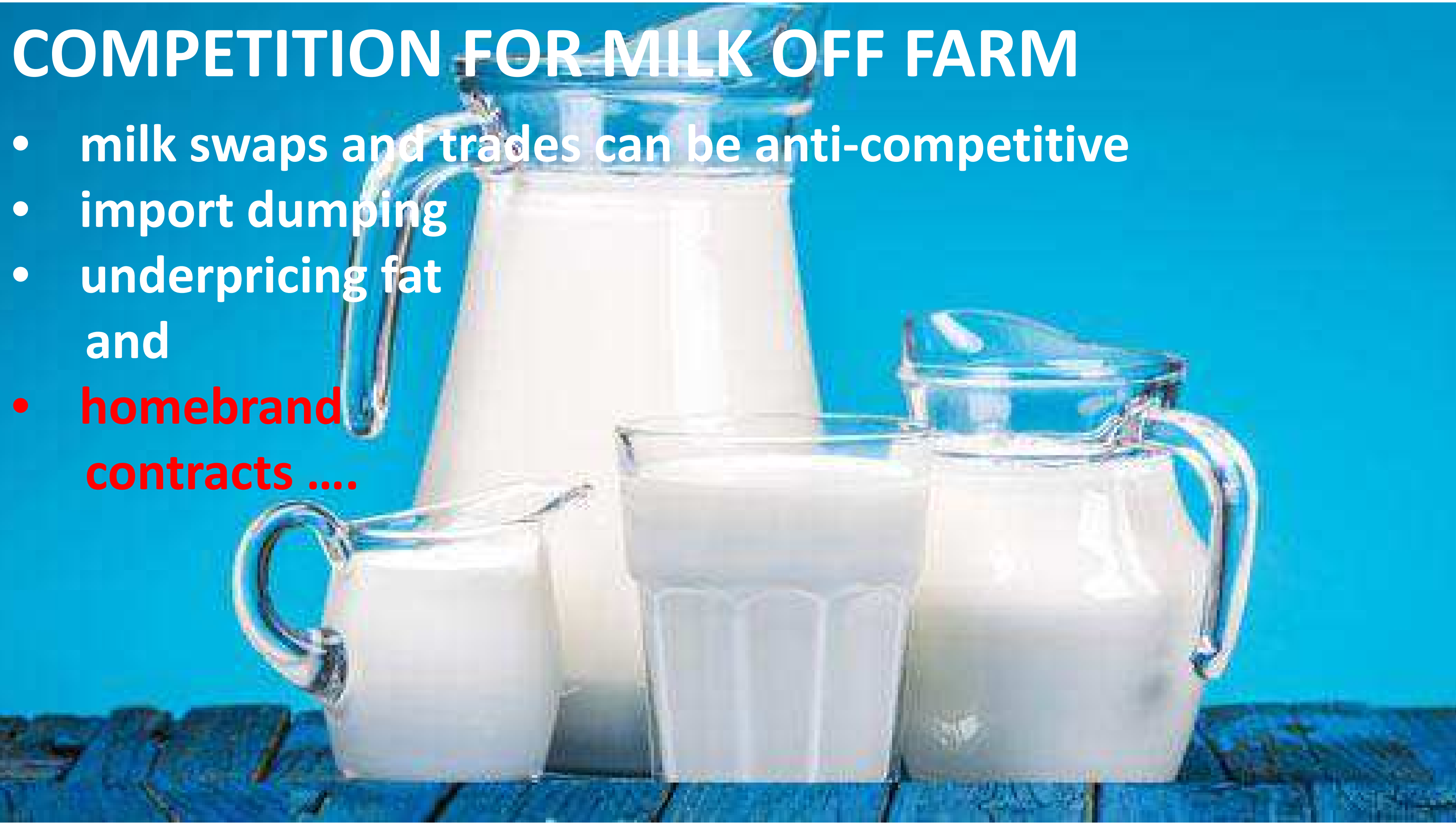
Pricing of milk

- Already below sustainable levels
- Forecast to go lower next year
- No accountability for prices
- Paying less than published price
- No transparency for payments made

The milk price has <u>not</u> stabilised as claimed and milk production will continue to fall through herd culling

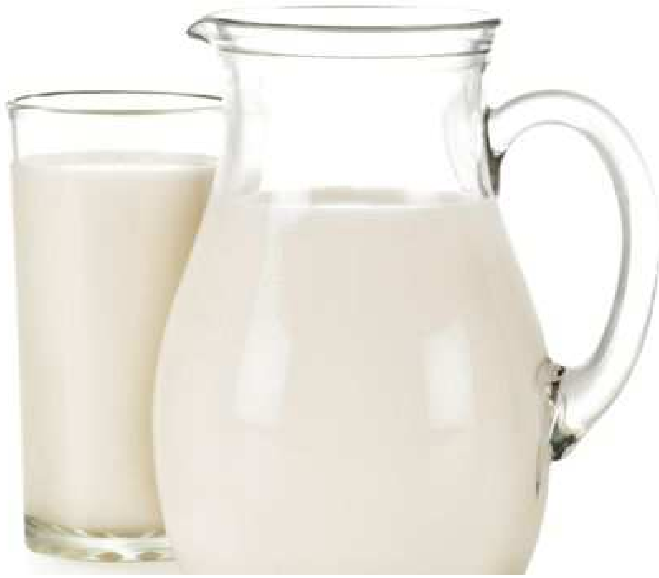
COMPETITION FOR MILK OFF FARM

- milk swaps and trades can be anti-competitive
- import dumping
- underpricing fat
  and
- homebrand
  contracts ….



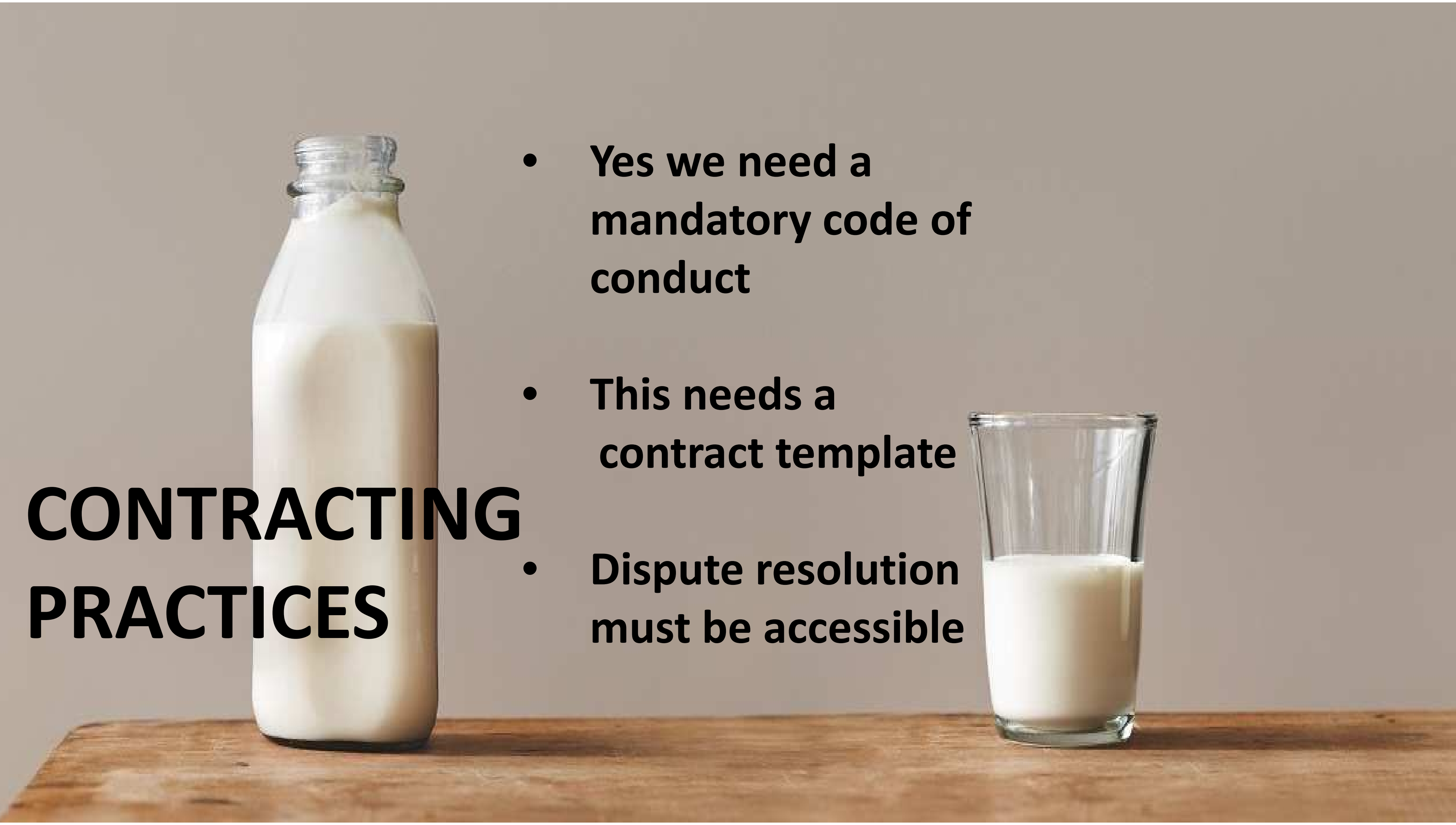
INDIRECT IMPACTS OF $1/L HOMEBRAND MILK NEED RECOGNITION

The ACCC Draft Report claims there are no direct impacts but accepts there may be indirect impacts.

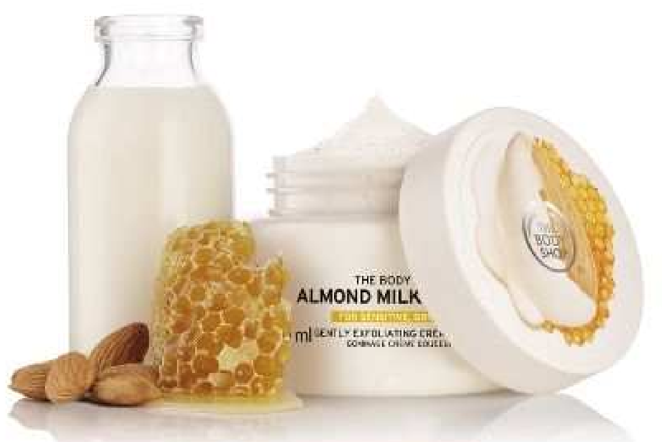


- **Domestic prices used to be a buffer against global price falls**
- **Initial price was negotiated in exchange for shelf space and market share**
- **It has pulled down the price of name branded milk from the start**
- **Renegotiated contracts pull prices down further (fear of underused plant)**
- **Miminal processing profits limits payment to farmers and sets an effective base price**
- **Indirect impacts include the damage to rural businesses and communities**

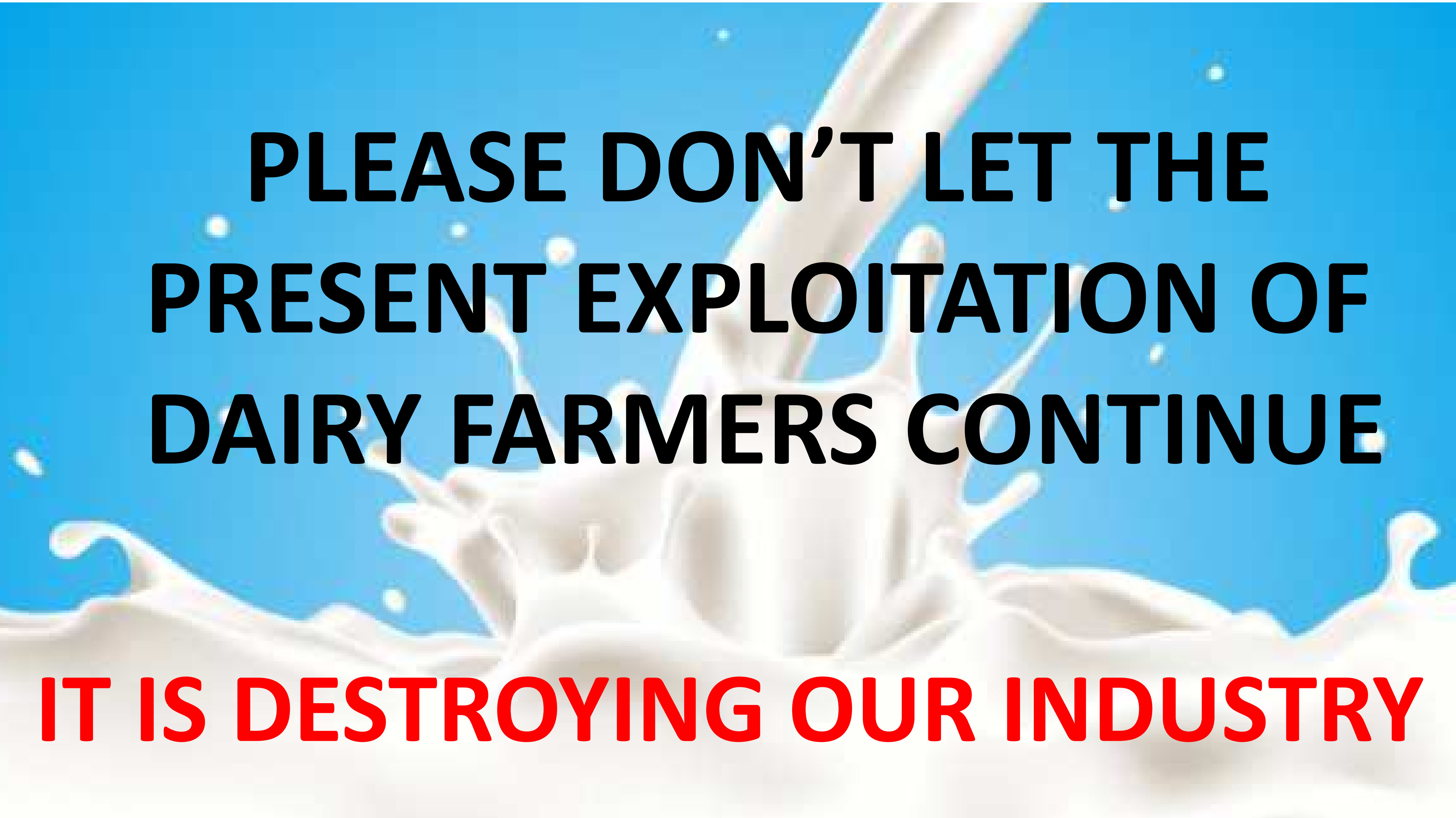
- **The consumer switch to name branded products was sustained (see DA report)**
- **However the benefits were not passed on to farmers**
- **There are ways to ensure that the benefits are passed on to farmers in future (see QDO proposal)**
- **There is no evidence that without this pressure homebrand prices will rise, so things will just get worse**
- **There are alternatives to ensuring affordable access to nutrition (skim milk + permeate)**


CONTRACTING PRACTICES
• Yes we need a mandatory code of conduct
• This needs a contract template
• Dispute resolution must be accessible

A GREAT OPPORTUNITY PRESENTS ITSELF



- The milkprice index could become MyMilkprice.com
- Align it with the contract template
- Enable farmers to calculate what they will actually receive
- The current national consultancy could design this
- Processors are already lobbying against index transparency
- This may need ACCC encouragement/intervention
- We would be happy to provide input to the website design


PLEASE DON'T LET THE
PRESENT EXPLOITATION OF
DAIRY FARMERS CONTINUE
IT IS DESTROYING OUR INDUSTRY