Submission
No 13

INQUIRY INTO SUSTAINABILITY OF THE DAIRY INDUSTRY IN NEW SOUTH WALES

Organisation: Narrawilly Farm

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Partially Confidential

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SUBMISSION TO THE INQUIRY INTO THE SUSTAINABILITY OF THE DAIRY INDUSTRY IN NSW

ROBERT MILLER, DAIRY FARMER: NARRAWILLY & CROOBYAR FARMS, MILTON, NSW

A. FOREWORD:

I am a farmer, not an activist or lobbyist or economist. I am presenting to this NSW Inquiry because there is a crisis in the fresh food sector, particularly in dairy. It should not have come to this.

Farmgate milk pricing is the key issue. It is not just the low price; rather, it is that low prices are being maintained despite every other market condition changing – such as drought, energy, water, fodder, labour.

There is such inequity in market power in the fresh food sector, that it has created a cost price squeeze which makes it unsustainable for farmers like me to continue production.

B. BACKGROUND:

- Fifth-generation dairy farmer on original 1859 rural property.
- Business size: 2 dry-land farms, with milking herd of 1,000 cows (but culled to 700 in September 2018 drought), with a production output at full capacity of 10million litres annually.
- Employment capacity at full production: 6 full-time and 8 part-time employees (but reduced to 3 full-time and 6 part-time employees currently).
- The farms are located on premium prime agricultural land on the NSW South Coast, which has had consistent rainfall of 1,200mm annually – all of which make for optimal conditions for dairying in NSW.
- My farmgate annual average milk price is 51 cents per litre.
- To remain profitable under low milk price market conditions, I have sold 200 heifers to export annually.

- My pre-drought 2018 production costs were 50 cents per litre.
- My current 2018 drought production costs are 80 cents per litre.
- It is unsustainable for my farms to continue milk production without additional financial resources.
- The dairies remaining in the Milton area are all fifth- and sixth-generation family businesses on prime dairying land. These farms have survived through drought and other adversities over 150 years, but in these current market conditions we are considering the unthinkable: ceasing farming operations. This is not due to bad management but rather due to unsustainable milk pricing which is now significantly below the cost of production.

C. KEY ISSUES / PROBLEMS:

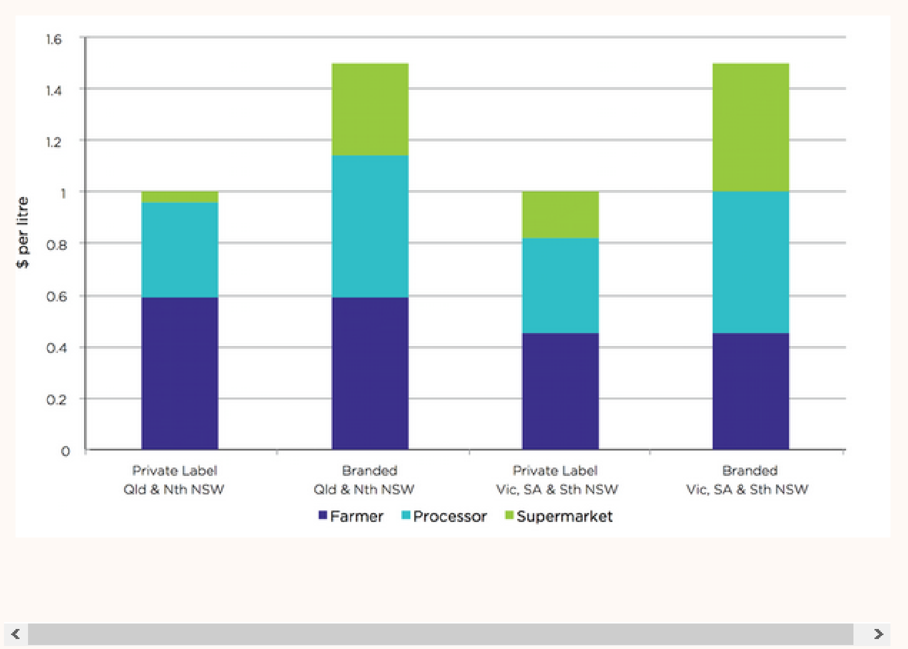
Issue / problem 1: farmgate pricing

- There is a crisis in dairy which preceded this drought and has been exacerbated by it.
- All the while, the cost of production has substantially increased in recent years, wiping out all productivity gains made at farm level since deregulation in 2000.
- The introduction of $1-milk in 2011 has severely impacted farmers' ability to achieve any farmgate price rises from the Processors. There is strong resistance from supermarkets to increasing the price, and who repeat to the media the evidence-free perception that $1-milk draws consumers into their stores.
- The milk market in NSW is predominantly fresh milk, required 365 days, while in Victoria production is seasonal and milk is used as a commodity in products such as milk powder intended for sale on the export market. The cost of production for 365 days is substantially higher than the cost of production on seasonal farms, with at least 10cents per litre more in production costs. It is, thus, invalid to compare NSW milk pricing with that of Victoria milk.
- Grain, pellet and hay suppliers have passed on their price increases to dairy farmers, as have power, water and insurance providers. But dairy farmers can't pass on their increased costs to anyone.
- A milk price that in good times fails to cover costs of production precludes farmers from being able to adequately prepare for drought, to innovate, and to allow for intergenerational transfer of farms. Dairy farming is now characterised by an ageing demographic who struggle to pass on their businesses to their children because there is no visible sustainable future or profitability at farm level. It also complicates succession because if there is an inheriting child, they require outside financial resources to buy out their siblings' share of the farm.
- Farmers are not receiving pass-through price increases from Processors. The ACCC report claimed that "Evidence obtained by the ACCC under our information gathering powers demonstrated that almost all contracts for the supply of private label milk have clauses that allow processors to pass-through movements in farmgate prices to supermarkets", but this has not happened. And it is unlikely to happen because farmers have severely limited market power and influence.
- Coles is selectively quoting from the ACCC report, claiming that it was an ACCC conclusion that there is no relationship between the farmgate price of milk and the retail price of milk. To argue that there is no relationship between farmgate and retail price suggests that the supply-demand dynamics of a competitive market don't exist. This is unquestionably a market failure in any market. This is a failure of the government's deregulation policy, as

efficiency cannot occur where price signals are distorted and corrupted by the retailing sector.

Issue / problem 2: farmers' market power

- Deregulation in 2000 has failed the most important contributor to the dairy industry, namely the dairy farmers themselves.
- Processors and supermarkets have benefitted at farmers' expenses from deregulation.
- Dairy farmers' bargaining power and ability to influence the price of milk have been weakened to the point of non-existence under current market conditions.
- The retail sector and Processors have manipulated the dairy value chain exclusively to their own benefits and profitability.
- Retailer and processor margins are greater than ever before, and retailer margins have increased from 12% under regulation up to 33% today on fluid milk.
- Likewise, the processor is now receiving as much for milk per litre as the farmer.



Distribution of revenue from sale of private label v branded fresh drinking milk: ACCC Dairy Inquiry

[Source: Chart from ACCC Dairy Inquiry]

- As recently as Wednesday, 30 October 2018, during a conversation with Parmalat, I was advised by Parmalat Marketing Manager, Steve Eldridge, that Coles had rejected all price rise requests presented to them in recent weeks. This highlights the market power of the retailer to set price and ignore the increase in production costs at farm level.

Issue / problem 3: deregulation

- Deregulation was meant to create a more competitive, efficient and innovative market. Initially, these changes occurred but are not happening now at farm level in NSW. Dairy farming under deregulation in 2018 is currently characterised by business behaviour common to subsistence farming, i.e. limited expansion and innovation, a reduction of its workforce, and heightened susceptibility to changing environmental conditions.

- Dairy farms have regressed from job-creating businesses hiring local community members initially after deregulation to operating with unpaid family members. This hides the true cost of production because labour costs are dramatically minimised or masked, and don't reflect the true price of labour. To fill short-term labour needs, backpackers are brought in. This undercuts dairy's contribution to the regional economy and community.
- Initially under deregulation, to achieve economies of scale and greater efficiency, farmers increased stocking rate to achieve margin. But, importantly, this has dramatically increased our exposure to drought, climate change and any adverse events.
- Increased stocking rates mean that farmers are more and more reliant on purchased fodder, such as hay and grain. Therefore, many dairy farmers are no longer self-sufficient. Our profitability and viability are significantly susceptible to fluctuations in the fodder market. Approximately 40% of farming costs are dedicated to buying purchased fodder for expanded herds which emerged due to pressures from deregulation.
- There is no oversight of the deregulated dairy sector, and no regulating authority to oversee fair market behaviour. (In banking, APRA plays this role.) We have seen abuse of market power which has enabled the processing and retailing sectors to claim ever-increasing margins at the expense of the farmer.
- It is worth noting that consumers did not ask for milk to be reduced from $1.30/litre to $1 in 2011. It was a decision taken by supermarkets, and enabled by the Victorian milk cooperative (Murray-Goulburn) which, at the time, was experiencing financial duress and in turn acquiesced to the supermarkets' $1-milk proposal. Murray Goulburn has subsequently collapsed but the contracts to supply $1-milk are locked in place. And dairy farmers, who have very little market power, are unable to force a change to this status quo.

Issue / problem 4: transparency and representation

- Transparency in a value chain is vital for an industry's success and innovation. The dairy industry is characterised by poor communication plus farmers' poor access to information about pricing at every stage of the value chain. Farmers do not have adequate information about key variables in their industry (e.g. processor-supermarket milk supply contracts such as for $1-litre milk; processor-logistics costs; etc.), and, hence, are in a weakened position at any negotiation stage because of gatekeeping of information.
- Dairy has a proliferation of representative bodies. In NSW alone there is Dairy NSW, Dairy Connect, NSW Farmers, ADF, and Dairy Australia. There is no united voice for dairy farmers. There is no central lobbying organisation. Yet dairy farmers pay a substantial amount in levies every year. Some of these bodies are significantly influenced by funding from Processors, which distorts the strategic decisions they make and the issues or problems they choose to pursue. It is also the case that Wesfarmers is the major sponsor of NFF and NSW Farmers, and any position taken by these organisations which is contrary to the interests of Wesfarmers (Coles) represents a risk to these organisations' financial lifeline.
- Dairy farming is time-intensive for farmers. With farms now operating with minimal labour resources, many farmers work 24/7/365. The implication is that progressive farmers have no time to participate in dairy farming industry matters as board members or thought leaders or lobbyists. Farmers have been forced into take-it-or-leave-it positions with milk contracts and farmgate milk price negotiations. Processors can cherry-pick farms and pursue a divide-and-conquer approach when contracting with farmers. Should a farmer's communication style displease a Processor representative, that farmer risks losing their milk contract altogether. Sometimes there is only one Processor in an area, which means the farmer doesn't have a choice of Processors which whom to negotiate.

E. RECOMMENDATIONS:

- Government intervention in the dairy value chain is required because the deregulation process has failed the most important contributors – farmers themselves:
  - To return market power to dairy farmers would enable fair, transparent negotiations yielding a sustainable farmgate milk price.
  - To appoint a Milk Commissioner to oversee market activity and who can guarantee ethical business practices by all players in the dairy value chain.
  - To stop the practice of loss-leader trading of perishable food products in the retail sector in NSW. The rationale is based on USA best practice where many states ban major retailers from using below-cost perishable foods as a consumer motivation to visit the store.
  - To introduce a recycling levy on all milk containers in NSW. The rationale is that the levy will break the perception and assumption that milk can be purchased for $1.

- To restructure dairy farmer representative bodies and lobbying entities. The rationale is to create a unified, farmer-driven industry body funded by the levy farmers pay currently.
- To legislate a minimum retail milk price in NSW for 2 years. The rationale is to restore sustainability to the dairy industry, and allow the industry time to restructure at farm level.

F: A NOTE ABOUT CONFIDENTIALITY OF SELECTED CONTENTS

- Section D and two appended letters are marked confidential, and I request that they not be published.

Regards,

Robert Miller