

**INQUIRY INTO SUSTAINABILITY OF THE DAIRY
INDUSTRY IN NEW SOUTH WALES**

Organisation: NSW Farmers' Association



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Inquiry into the Sustainability of the
Dairy Industry in New South Wales**

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About NSW Farmers

A profitable and sustainable New South Wales farming sector

The NSW Farmers' Association is Australia's largest State farming organisation representing the interests of its farmer members.

Farmers across New South Wales produce more than \$15 billion worth of food and fibre every year, representing around one quarter of Australia's total agricultural output. Our state's unique geography means a wide variety of crops and livestock can be cultivated and nurtured. NSW Farmers is Australia's only state-based farming organisation to represent the interests of farmers of all agricultural commodities – from avocados and tomatoes, apples, bananas and berries, through grains, pulses and lentils to oysters, cattle, dairy, goats, sheep, pigs and chickens.

Our focus is not just on issues affecting particular crops or animals – it extends to the environment, biosecurity, water, economics, trade and rural and regional affairs. We also have an eye on the future of agriculture; we are advocates for innovation in agriculture, striving to give our members access to the latest and greatest innovations in research, development and extension opportunities. Our industrial relations section provides highly specialised advice about labour and workplace matters.

Our regional branch network ensures local voices guide and shape our positions on issues which affect real people in real communities. Members are the final arbiters of the policies of the Association – through our Annual Conference and elected forums such as Executive Council, members can lobby for the issues which matter to them and their community to become Association policy. Our issue- and commodity-specific Advisory Committees are elected by members to provide specialist, practical advice to decision makers on issues affecting the sector. We are proudly apolitical – we put our members' needs first.

In addition, NSW Farmers has partnerships and alliances with like-minded organisations, universities, government agencies and commercial businesses across Australia. We are a proud founding member of the National Farmers' Federation.

Executive summary

NSW is the second largest dairy producing state in Australia. The dairy industry in NSW is unique, given its diverse geographical spread and associated environmental conditions. However, at present, dairy farmers in NSW are facing several challenges. Concerted action is required to ensure the ongoing sustainability of the industry. The NSW Government has an important role in supporting and growing the NSW dairy industry by investing in areas to facilitate growth and developing policies that support farmers businesses.

The structure of the NSW dairy industry has undergone a dramatic shift since deregulation. Although the whole supply chain has adapted to meet changed market conditions, it has created difficult environments for farmers. In particular, deregulation has concentrated the number of processors, who are now generally internationally-owned rather than co-operatives, leaving competition limited in certain regions. Deregulation has also opened the Australia industry to the global market, and this has tied the domestic milk price to a volatile international market currently characterised by low prices and oversupply. The power and tactics of retailers has also shifted under deregulated market conditions, especially with the development of private label products and loss-leading marketing tactics to drive consumers into stores. Ultimately these markets conditions and industry structure have created a difficult environment for farmers to demand fair prices for their product, hindering farm profitability.

NSW dairy farmers' profitability has also been hindered by a challenging operating environment. Severe drought and consequent increased input costs have tightened already tight margins, led to lower on-farm investment and reduced confidence. Dairy farming input costs are significant, with considerable initial infrastructure costs to establish sheds, milk cooling facilities, and also ongoing price pressures in relation to the core resources of energy, water, and adequate skilled labour. To ensure sufficient farm profitability, dairy farmers reduce on-farm costs and activities considered non-essential to everyday milk supply. However, short term cost savings can have long term effects on the industry. There is an urgent need for greater margin maximisation to ensure that cost cutting does not inhibit the sustainability of the industry or the ability of farmers to manage investments in their herd. Increased margins will allow for greater investments into the industry and better risk preparedness.

Recommendations

NSW Farmers encourages the Committee to consider the following in its final report to Parliament:

1. That a NSW dairy industry plan is developed which outlines the future of the NSW industry within the broader Australian context, and articulates the role of Government.
2. That any NSW dairy industry plan has clear targets and indicators to allow progress to be tracked.
3. That the NSW Government establish a NSW Commissioner for Agriculture to advocate on behalf of the farming sector and help rebalance power relationships in supply chains.
4. That the NSW Government commit to invest to modernise the regional electricity network to deliver affordable, reliable, and sustainable energy. This includes
 - a. Committing to implement ACCC recommendations
 - b. Committing to reduce electricity prices by 20% in four years, as per ACCC analysis.
 - c. Establishing a regional electricity innovation fund, as well as a fund to write off un-utilised regional network assets.
5. That the NSW Government increase investment in programs to enhance water infrastructure for dairy farmers' to enhance efficiency and increase productivity.
6. That the NSW Government enhance investment in business management and skills programs.
7. That the NSW Government resource education programs about farming systems to enhance community understanding.
8. That the NSW Government implement a legislated Right to Farm, to protect agriculture and to support more effective planning for regional and peri-urban areas.

Impact of Deregulation

Deregulation of the NSW dairy industry has had a large impact on farmers, with the supply chain fundamentally changing and increasing pressure on farm profits.

The market dynamics of the NSW dairy industry transformed with deregulation. Processors reset their businesses to an open competitive market model, and manufacturing had to adapt to higher costs of milk. Retailers also engaged in various strategies, initially with an increase in branded products and then the development of private label milk, which has since been discounted to drive market share. These changes have created pressure throughout the dairy supply chain as industry participants have had to compete for market share.

Farmers' profitability was affected by changes to the milk price. The milk price fell heavily after deregulation, dropping below 30 cents per litre. Although prices lifted in 2007 and 2008 to 45 and 55 cents per litre—an improvement from the regulated price—there has been little to no improvements in price over the past decade. This is problematic when one recognises the significant increases in energy and other inputs.

Some farmers previously found that the regulated industry was overly restrictive and prevented growth within a business. Deregulation has allowed them to improve their productivity and grow their business. Overall the state's dairy industry may have survived, but this is largely due to business consolidation and improved productivity as many individual farmers have exited the industry in the past fifteen years.

Dairy Industry Plan

Deregulation has had a significant impact on the NSW dairy industry. It is essential that the industry develops a clear industry plan that articulates both the challenges and opportunities within this new environment, as well as the strategies for addressing these.

RECOMMENDATION:

- 1. That a NSW dairy industry plan is developed which outlines the future of the NSW industry within the broader Australian context, and articulates the role of Government.*
- 2. That any NSW dairy industry plan has clear targets and indicators to allow progress to be tracked.*

Supply Chain Relationships

The dairy supply chain has three distinct relationships: dairy farmer – processor; processor – retailer; and, retailer – consumer. Each of these relationships is highlighted by power imbalances between participants. By virtue of their position at the beginning of the chain, farmers have limited opportunity to resist these pressures. Dairy farmers are highly concerned with the ability of the retailers to squeeze margins from the rest of the supply chain, particularly with one dollar litre milk.

Dairy Farmer – Processor Relationship

Farmers and processors contract for the sale of raw milk. This relationship is marked by a clear market power imbalance and the difference in bargaining power enables processors to shift risk to farmers. The transfer of commercial risks means that farmers operate with a high degree of uncertainty.

Competition between processors is limited as the market for the supply of raw milk is geographically restricted by the ability to viably transport milk for processing. The ACCC dairy inquiry found that geographic markets in Victoria and southern NSW have higher levels of processor competition for raw milk, with dairy farmers having up to eight processors competing for their supply. In contrast, farmers in the central milk pool, which encompasses most of NSW, typically have less competition for their milk. Farmers are at a serious disadvantage when it comes to negotiating contract terms or price. Our members have noted particular instances where there was competition between two processors in a region, however one processor withdrew and left them no choice but to supply the other processor (who had no obligation to take them on) or leave the dairy industry.

The perishable and relentless nature of dairy production leaves farmers in a weak bargaining position as compared to processors. A dairy farmer cannot and will not challenge the prices or terms offered by a processor, as any renegotiation or conflict will mean spoilage of their milk.

Furthermore, all costs in dairy farms are either sunk or fixed in the short to medium term, so any disruption to revenue cannot be mitigated by lowering operational costs.

The information disparity between farmers and processor further weakens farmers' bargaining position. Farmers are faced with complex contracts that differ widely between each processor. This makes it difficult for a farmer to identify benefits in switching processors—if they even can—and increases the lack of transparency in the relationship.

The ACCC addressed the issue of transparency in their final report into the dairy industry and made several recommendations to improve the discrepancy in contract information and supply of

supporting documentation to farmers by processors. NSW Farmers strongly supports these recommendations. Successful implementation will improve the transparency around contract negotiations for farmers and would be a step forward in building trust in the farmer-processor relationship. There is a great need for programs to allow for increased resources for farmers to understand contracts and supporting documentation from processors.

The ACCC also recommended that a mandatory code be developed to moderate the imbalance in bargaining power between farmers and processors. The mandatory code is important in improving transparency on the minimum content of milk supply contracts, monitoring compliance, and addressing breaches. Farmers are at a disadvantage in negotiating milk contracts as they are small businesses entering contracts with processors, who are generally larger companies.

NSW Farmers also proposed the introduction of a national standing market offer at the national level to redress the disproportionate allocation of risk on farmers. A standing offer regime would require processors to provide one market offer that has standard terms and conditions, and clear and transparent pricing. There are significant benefits to a standard market offer, as it would provide clarity and comparability for farmers, enhancing transparency around pricing and enabling farmers to access the best returns. More importantly, it provides the market with information as to the value of risk. As an example, prices can be compared between a processor's standing offer and an alternate market offer, where risk has been apportioned differently. The difference in this price is effectively the value of carrying the above mentioned risks. Over time this process, would provide farmers with better knowledge, and overcome some of the information asymmetries that provide processors with unreasonable market power.

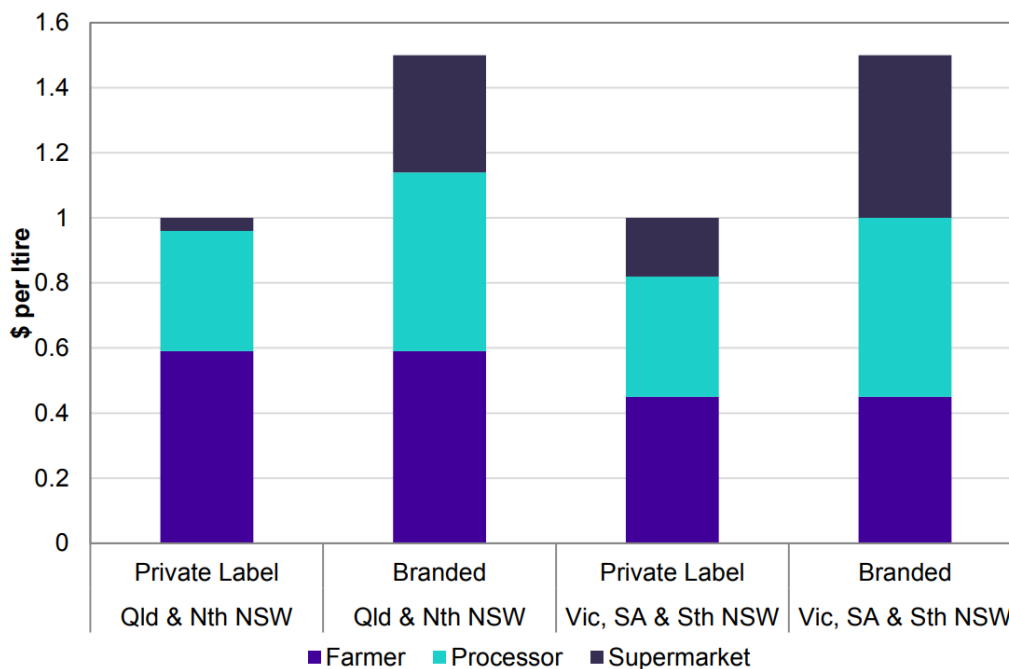
Processor – Retailers

There is a strong link between the lack of competition in the processing sector and the end market of these products, being one controlled by a few retailers. This correlation demonstrates the power and the ability of retailers to squeeze margins from the rest of the supply chain, particularly in establishing one-dollar a litre milk. The unreasonable discounting of milk and other dairy products has had negative impacts on the dairy industry. Discounting has the potential to seriously damage the NSW industry in the long term, by continuing to force dairy farmers to exit the industry and thereby damaging its sustainability.

The impact of retailer discounting on the dairy industry was examined in the ACCC Dairy Inquiry. Analysis by the ACCC of farm-gate, processor, and retail prices for fresh milk highlights farmers' weak bargaining position. Regardless of price differentials in the retail price of private label and branded fresh milk, the revenue for the farmer remained unchanged. Furthermore, the line share of

any price increase in retail prices went to the retailer, highlighting its strong bargaining position within the supply chain.

Distribution of revenue from the sale of fresh drinking milk



Source: ACCC analysis from supermarket and processor data

Perversely, the ACCC used this data to conclude that: ‘dollar a litre’ private label milk has no adverse impacts on dairy farmers; that the impacts were felt by the reductions in margins for the processor and retailer; and, as such, not a concern from a competition or market power perspective. This shows a lack of commercial understanding by the ACCC. Processors do not purchase milk from farmers for the specific purpose of supplying branded or private label milk. Any price pass-through to farmers will be determined by the average price obtained by the processor from the retailer. This means if the average retail price of milk falls, the average farm-gate price will also fall. This is why dollar a litre milk is viewed with such negativity by dairy farmers.

NSW Farmers have concern with the ability and effectiveness of competition law to provide fairness in supply chains. Owing to these deficiencies the Association has undertaken to engage directly with retailers to discuss their corporate social responsibility and sustainability programs, which place a burden on the supply chains, and to discuss solutions to ensure a sustainable NSW dairy industry.

Retailers – Consumer

Australian consumers have a justified expectation that dairy products are safe and of high quality. These products must also adhere to high standards of welfare, environmental, and workplace

relations. However, the desire for quality is also accompanied with an expectation that the product will be low cost. There is a need for the Government to educate the community on the dairy industry to engender greater support for the industry and support profitable farms.

NSW Commissioner for Agriculture

The ability for the New South Wales Government to mandate trading terms is limited. However, given the unequal bargaining power within food supply chains, and concerns about competition and abuse of market power, the establishment of a state-based commission or advocate for the farming sector to address issues relating to:

- code compliance following the establishment of the Mandatory Dairy Code;
- advocacy on behalf of the farming sector on competition and abuse of power matters; and
- analysis and monitoring of farm-gate and retail prices on a basket of goods to assess competitiveness within supply chains.

RECOMMENDATION:

That the NSW Government establish a NSW Commissioner for Agriculture to advocate on behalf of the farming sector and help rebalance power relationships in supply chains.

Input Costs

The profitability of dairy farms is affected by input costs and the margin from the farm gate milk price. The NSW dairy industry operates in a high cost environment of a first world country with high and justified expectations of quality, as well as environmental, employment, and animal welfare standards. Farms also must use several key inputs, including energy, water, and feed. While the costs of these key resources have increased, the farm gate milk price has not been affected. NSW dairy farms are more vulnerable to input price increases as they have generally become more intensive since deregulation, requiring greater use of these resources.

The NSW Government has a key role to play in investing in programs to support and increase the resilience of dairy businesses. This investment must be in both up skilling businesses and individuals, and investing in infrastructure projects to enhance the profitability and productivity of the industry. The Government also has a key role in reducing unnecessary regulation to facilitate an environment where businesses can operate effectively.

Feed Costs

Dairy farmers feed costs have increased sharply under the current drought conditions. It is expected that these high costs for grains and hay will remain for at least eighteen months. The cost of hay and fodder has been most substantial in the North Coast region, which is experiencing increases of 78 per cent, and the central west, which has suffered a 254 per cent increase.¹ The cost of grain in these regions has also risen substantially with increases of 40 per cent in both areas.² While destocking is a possibility and some farmers have reduced their herd, it is not a widely undertaken practice. Dairy farmers are limited in their capacity to destock as this would impact heavily on milk production and affect processor contracts.

NSW Farmers have strongly advocated for dairy farmers' to be paid fair returns so that their businesses are sustainable in both good and poor seasons. The Association is concerned by the drought levies introduced by retailers, as they fail to acknowledge the pressure that farmers have been under for many years and do not address the structural problems with the industry.

Energy

The energy profile for a dairy operation is higher than most agricultural industries. Energy reliance is largely because cows require milking twice a day, with the milk refrigerated on farm in bulk tanks

¹ Dairy Australia, Situation and Outlook October 2018, 9.

² Dairy Australia, Situation and Outlook October 2018, 9.

until collected by the processor which is generally within 24 to 48 hours. This energy use can equate to approximately 20 per cent of a farms operating costs.

Dairy farmers are also indirectly impacted by costs increase as processors capacity to pay is reduced with energy increases. Analysis undertaken by Dairy Australia suggests that the current cost of energy (electricity and gas) for dairy processors is in excess of \$170 million. Based on new contracts being negotiated by processors, this cost is set to increase by a further \$100 million in 2017/18. This will affect farm-gate milk prices.

Of equal concern is the increased risk of supply disruptions. Sites will be affected differently, for example, power blackouts:

- would cause significant issues at sites that blow-mould their own plastic milk bottles, including significant times required to restart production lines;
- unfinished dairy products within process lines and storage vats are also likely to become unusable;
- loss of production at critical times may affect a processor's ability to meet supply contracts, with severe commercial implications; and
- The cost of acquiring and maintaining back-up diesel or gas generation adds significant costs to a business that already operates on small margins.

A more affordable, reliable, and sustainable energy sector for regional NSW is needed for the sustainability of the dairy industry.

RECOMMENDATION:

That the NSW Government commit to invest to modernise the regional electricity network to deliver affordable, reliable, and sustainable energy. This includes

- a. Committing to implement ACCC recommendations*
- b. Committing to reduce electricity prices by 20% in four years, as per ACCC analysis.*
- c. Establishing a regional electricity innovation fund, as well as a fund to write off un-utilised regional network assets.*

Water

Water availability is a priority in the dairy industry. Dairy farmers throughout the state are reliant on continual water access, through irrigation licenses, as well as access to feed from out of season and off-farm sources. Dairy farmers are currently being pressured with increasing prices and also greater

competition for water resources. The Murray Darling Basin Plan is impacting on-farm productivity and profitability of dairy farmers. To ensure the continued viability of the southern NSW dairy industry it is crucial that no further water is taken out of productive use. NSW Farmers Association recommends the last minute addition of the 450GL “upwater” on top of the 2750GL target for environmental water recovery be removed from the Murray Darling Basin Plan.

To ensure that dairy farmers can access affordable and reliable water resources there is a need for greater investment in water infrastructure to better adapt to greater climate variability. The Lachlan Valley is a growth area for the dairy industry and there is the need to ensure that this area has the water resources available to continue this into the future. The Government is currently considering a recommendation to raise the Wyangala wall and this would make a significant difference to the

There is also a need for government to provide farmers with assistance in making on-farm water development. Currently this support is being provided in the form of the Farm Innovation Fund and this has been used to enable investment in water resources, to minimise reliance on external feed.

RECOMMENDATION:

That the NSW Government increase investment in programs for water infrastructure to enhance efficiency and increase productivity.

Infrastructure

Government must continue to provide assistance and incentives for dairy farmers to invest in on-farm infrastructure projects to enhance farm productivity. The Association advocated for the underpasses program in NSW and acknowledges the Cattle Underpass Scheme that was launched in mid-2018. The scheme recognises the importance of improved farm productivity, increased animal welfare, and better safety for motorists. This scheme should be reopened as seasonal conditions hindered applications in its initial operation.

Business Development

Programs such as farm management skills for young farmers and risk proofing management skills are important to support the growth of the industry. The dairy industry needs to be supported for the future so that young farmers are able to enter the industry and remain profitable into the future. Investment in infrastructure projects ensures that farmers can lower their farm input costs, such as with energy and water usage. As noted previously, dairy farmers have high input costs which restrict investment into the industry and individual businesses. Without investment the industry will stall and efficiencies will be lost. To help facilitate growth, there needs to be investment in critical

support for productivity improvements and ensure that large-scale operations do not face significant regulatory burdens.

RECOMMENDATION:

That the NSW Government enhance investment in business management and skills programs.

Workforce

The dairy industry is facing a shortage of skilled workers for on-farm work. Attracting new talent is a key objective for the dairy industry as well as ensuring there are adequate programs available for the development of a highly skilled workforce that helps build industry capability. There are a range of programs that need to be developed in this area to support industry in attracting and retaining sufficient workers. NSW Farmers is currently advocating for a joint industry and government program that encourage graduates to enter the dairy industry and take up on-farm careers.

Mental Health

The issues impacting the dairy industry have had a serious adverse impact on participants' sentiment and on the mental health of some dairy farmers. These impacts cannot be quantified. Farmers have reported a clear psychological impact of one dollar per litre milk, as they have seen retailers devalue their product and the price not reflect the cost and skill involved in its production. It is vital that mental health and support services are available so farmers can be supported.

Transport & Roads

The dairy industry operates in regional and rural NSW, and productivity gains and increased market penetration will rely on connected infrastructure to meet current and future demand. There is a need for strategic investment in transport infrastructure to deliver these gains for the industry. The Association requests that the \$4 billion Snowy Hydro Legacy Fund is used to develop a 3 hour travel between the Central West and Sydney, and to deliver strategic and well-connected regional hubs.

There needs to be greater flexibility in allowing efficient on and off farm transport so that the industry is not restricted by the 'first and last milk syndrome'. The unnecessary regulation around vehicle movements needs to be addressed to ensure that farmers are supported and not burdened with unnecessary costs.

Research and Development

The Government must invest in targeted dairy research into farming systems that address climate variability and other resources management challenges. This research is required to ensure that the industry has production systems that support productivity farms in the various regions of NSW.

Education

Dairy is a significant contributor to the New South Wales economy and a vibrant, sustainable and productive dairy industry sector depends on a knowledgeable and supportive community.

Agribusiness is critically important to the Australian economy but is rarely identified in curriculum areas of STEM, economics, English, geography, civics, and other social sciences. Digital technology and advances across most fields of science are transforming production practices and making agriculture more sustainable and efficient. The trajectory of dairy and agriculture in general as a respected and valued profession is dependent on attitudes to agriculture and agribusiness that are based on science and factual information. This is the natural province of the classroom. There is an important place for agriculture with respect to the disciplines of history, culture, science, political and international affairs, and professional development.

Broad community understanding of the primary industries sector is low. The most recent school student survey by the Australian Council of Educational Research into awareness of primary production showed that 43 per cent did not link science to primary production; and 55 per cent did not link innovation to primary production.³ However, there is no doubt that teachers in primary and secondary schools consider it important to engage students with food and fibre production.

RECOMMENDATION:

That the NSW Government resource education programs about farming systems to enhance community understanding.

³ Food, Fibre and the Future: Report on Surveys of Students' and Teachers' Knowledge and Understanding of Primary Industries, Undertaken by ACER (Australian Council for Educational Research) for PIEFA (Primary Industries Education Foundation) October 2011.

Planning and land use conflicts

The current planning and development system does not sufficiently support the NSW dairy industry. Changes are needed to reform the system so as to promote, rather than restrict, dairy farming in regional planning policy at all levels, local, regional, and state.

Dairy farmers have been hindered in growing their business and enhancing productivity of their operations due to the difficulty in gaining approval for infrastructure developments. The system needs to be reformed to enhance consistency in application of planning rules across the State and a streamlined development application process. There is also a need for industry and government to collaborate to ensure that best practice infrastructure is developed and farmers are supported through the process.

Land use conflict is another key planning issue where dairy farmers have been insufficiently protected. Farmers are increasingly being placed under pressure from urban expansion, creating conflict between the urban community and the ability of farmers to operate their lawful businesses. The planning system must protect farmers from these nuisance complaints and support the dairy industry.

RECOMMENDATION:

That the NSW Government implement a legislated Right to Farm, to protect agriculture and to support more effective planning for regional and peri-urban areas.