REPORT ON PROCEEDINGS BEFORE

PORTFOLIO COMMITTEE NO. 5 – INDUSTRY AND TRANSPORT

INQUIRY INTO SUSTAINABILITY OF THE DAIRY INDUSTRY IN NEW SOUTH WALES

CORRECTED

At Macquarie Room, Parliament House, Sydney, on Friday 16 November 2018

The Committee met at 9:00

PRESENT

The Hon. Mick Veitch (Acting Chair)

The Hon. Rick Colless
The Hon. Wes Fang
The Hon. John Graham
The Hon. Scot MacDonald
The Hon. Mark Pearson

The ACTING CHAIR: Welcome to the second public hearing of the Portfolio Committee No. 5 inquiry into the Sustainability of the dairy industry in New South Wales. Before I commence I acknowledge the Gadigal people, who are the traditional custodians of this land. I pay respect to the elders past and present of the Eora nation and extend that respect to other Aborigines present here today. Today the Committee will hear evidence from the following government and dairy industry representatives: the Department of Primary Industries, the NSW Farmers Association, Norco Cooperative Limited, the Australian Competition and Consumer Commission, dairy farmer Mr Phil Ryan, and the Dairy Farmers Milk Co-operative.

Before we commence I will make some brief comments about the procedure for today. Today's hearing is open to the public and is being broadcast live via the Parliament's website. A transcript of today's hearing will be placed on the Committee's website when it becomes available. In accordance with the broadcasting guidelines, while members of the media may film or record Committee members and witnesses, people in the public gallery should not be the primary focus of any filming or photography. I remind media representatives that they must take responsibility for what they publish about the Committee's proceedings. It is important to remember that parliamentary privilege does not apply to what witnesses may say outside their evidence at the hearing. I urge witnesses to be careful about any comments they may make to the media or to others after completing their evidence as such comments would not be protected by parliamentary privilege if another person decided to take an action for defamation. The guidelines for the broadcast of proceedings are available from the secretariat.

There may be some questions that witnesses could only answer if they had more time or with certain documents to hand. In these circumstances witnesses are advised that they can take the question on notice and provide an answer within seven days. Witnesses are advised that any messages should be delivered to Committee members through the Committee staff. To aid the audibility of this hearing, I remind Committee members and witnesses to speak into the microphones. In addition, several seats have been reserved near the loudspeakers for persons in the public gallery who have hearing difficulties. Finally, I ask everyone to turn their mobile phones to silent for the duration of the hearing.

SCOTT HANSEN, Director General, NSW Department of Primary Industries, sworn and examined

ALEX RUSSELL, Manager, Intensive Livestock, NSW Department of Primary Industries, sworn and examined

The ACTING CHAIR: I welcome our first witnesses from the NSW Department of Primary Industries. The Hon. Robert Brown passes on his regards. He is ill and unable to be here today. Would either of you like to make a brief opening statement?

Mr HANSEN: The key thing for us, which was picked up in our submission, is that we are acutely aware of the importance of the dairy industry to the State of New South Wales. Not only is it worth more than half a billion dollars in gross domestic product [GDP], it also represents more than 660[1] dairy families and dairy businesses across the State. The 2017-18 year has been extremely tough for those businesses. In fact, in the seven years that we have been doing the Dairy Industry Farm Monitor Project, which monitors the economic and physical performance of dairy farms across the State, this has been the lowest year of return for dairy farmers. That has largely been driven, of course, by the fact that seasonal conditions have driven up input prices for fodder, feed and water considerably. It has been an incredibly tough year for the industry.

As a part of that farm monitor program we ask dairy farmers at the end of each year what they see as the key issues facing them over the next five years. Not surprisingly, given the year they have come out of, the top four issues for this year were: first, input costs. Hopefully in both our submission and in any follow up questions, we can point to some of the incredible work that our research teams—not only within the dairy team but also in our livestock, pasture, cropping and fodder teams—as well as the collaborative work we do with other jurisdictions including the Commonwealth Scientific and Industrial Research Organisation and other research institutes, are doing to continue to provide reductions in input costs for dairy farming operations. The second issue was climate and season. With the work we are doing to try to increase the resilience of pastures, feed bases, water utilisation and production efficiencies, we have a good suite of work happening, in addition to what we have on the table with the drought support assistance, should this season continue to pan out the way it is.

The third concern was pasture and fodder. Again, we have a strong research and development collective, not only within the State but also along the eastern seaboard with other jurisdictions on that front. The final concern was milk prices. From the perspective of the Department of Primary Industries, the key areas in which we can have an influence in that space are: first, around ensuring that dairy farmers continue to have access to markets by ensuring that biosecurity requirements continue to be met, keeping as many markets open to them as possible and allowing them access to as many customers as possible. Secondly, it is around ensuring the ongoing food safety credentials and outcomes from the dairy industry, with the prospect of not only maintaining access to customers by maintaining that food safety but also maintaining the high-quality reputation that our dairy industry has globally, which allows it to access markets that other competitors do not necessarily get the opportunity to tap into.

Finally, we do some pieces of work around novel products, processing and approaches to value add. One of the most recent examples is out work in high-pressure processing, which looks at alternative ways of producing safe raw milk products without using heat treatment or pasteurisation. They are the three key areas that we are working in in the price space. But we understand that the dairy industry has some significant challenges coming out of this year and some significant challenges going forward. We are looking forward to hearing the remainder of the evidence over the next two days of hearings and seeing the Committee's report.

The ACTING CHAIR: Thank you very much.

The Hon. RICK COLLESS: Thank you for coming in today. Mr Hansen, with regard to the comments you made about production efficiencies, I get the feeling from the farmers who we have already spoken to that they are at their wit's end with regard to increasing their farms' productivity. I certainly got the feeling at our last hearing that there was no more room for them to become more efficient as far as their operations go. Where do you see that going? I understand that with the industry research you are doing there will always be improvements

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made at that level, but as far as farmers becoming more efficient is concerned, these guys do not know where to turn next. They are telling us that the drought has made it worse, but that it is not the root of the problem. It is the price they are getting that is the real problem.

Mr HANSEN: I cannot think of any industry that we deal with that could put their hand over their heart and say it is as efficient as it will ever possibly be and that the opportunity for productivity improvements does not exist in the sector. We know from the results of our farm monitor project that the variation between the top 25 per cent of performers and the bottom quartile is not insignificant. Therefore, even within the group there are always opportunities for individual businesses. The challenge we have is trying to articulate for you what the most successful model for dairy farming is going forward because there is such a diverse range of models that are used. There is everything from models that use high-volume intensive production systems that utilise economies of scale and automatic milking systems to generate cost efficiencies all the way through to, for example, one of the most profitable farms in our farm monitor project, which is a very low input cost extensive production system that has developed a niche for its products and is keeping its cost base extremely low whilst doing so.

So there is no one size fits all and that is one of the hard things in dealing with any of our groups in agricultural production. We call them dairy farmers, we call them meat producers, we call them poultry growers. Everyone has a very different business and part of the work that we do, not only through our farm monitor project in providing each business with the opportunity to benchmark against other like businesses within their district, within their State and within their region—because not only does that give them a chance to look for where those productivity gains are still to be made for their individual business—but we also still run what must be one of the last commercial dairies focused on the provision of training at Tocal.

So the combination of those two things helps us guide where we can help individual businesses, and where we can help the industry more generally is largely set by the work of dairy farmers with groups like Dairy Australia in identifying the productivity gains they are looking for and the areas for future investment. You can see in their investment portfolio that genetics plays a significant role in where they see the next big productivity gains.

The Hon. RICK COLLESS: The Australian Competition and Consumer Commission [ACCC] report—and you refer to this in your submission—says that domestic retail milk prices are not the main influence on farmgate prices yet when we look at what has happened to the price since deregulation, they have dropped from around 80¢ a litre pre-deregulation to in some cases as low as 40¢ a litre now and with the $1 milk, there has been a lot of criticism of that from the producers. What has happened since deregulation that has forced that price down to that extent? It seems crazy that we were selling a product in 1996 and getting 80¢ a litre for it yet here we are over 20 years later getting half the price for it. How can you expect producers to survive in that environment?

Mr HANSEN: That is where we have the distinct advantage of being able to say we look forward to your line of questioning from the ACCC this afternoon when they are here. Our dairy industry does operate in a global market and despite how much gets sold export versus domestic, the access and opportunity to have alternative customers is a tool that is used across many industries to help ensure fair pricing in your own domestic market. That threat of being able to move to an alternative customer should those prices not continue to meet is always there. Obviously milk being a competitive product and the vast majority of New South Wales milk produced is for drinking purposes and is fresh milk produced does make it more vulnerable in terms of that supply-customer relationship.

At the same time, it also significantly increases the cost as you have to try to maintain a steady supply year-round for that fresh milk supply contract. We note the comments that the ACCC has made. They have done a much more detailed analysis of what has happened and therefore they are best placed to comment on that. We just keep reflecting on the results we see out of the 32 farms across the State that we monitor in quite some detail; 2017-18 saw an increase in their milk price.

The Hon. WES FANG: The farmgate milk price?

Mr HANSEN: The farmgate milk price, but the very worst financial outcome for those farms, driven solely by the input costs side of the equation.

The Hon. RICK COLLESS: On the back of that, can I ask you what the farmgate price was approximately across those 32 farms and did that actually include their labour costs and wages costs for the principals of those companies? We heard on Monday that the farmgate price, their costs of around 50¢ or 60¢ a litre, did not include the wages for the family members who were operating the farm; in fact, they were taking some wages out of it as low as $20,000 a year, which is way below the poverty line.

Mr HANSEN: I might let Mr Russell run through a summary of the results, bearing in mind that when we look at the New South Wales industry, the industry does not necessarily operate on State borders; it operates more on the geographic divide of the south and the north so we might reflect south and north in those number.

Mr RUSSELL: Thanks, Mr Hansen, and Mr Colless. For the purposes of our analysis we divide the State into north and south reflecting the different milk markets that those farmers are supplying into. In answer to your question about price, the average farmgate price received for southern farmers in New South Wales was 50.6¢ per litre in the sample included in our analysis and in the north it was 56.5¢ per litre. That premium in the north partially reflects the higher cost of production in northern New South Wales but also I think the processes in the north are offering that sort of premium to shore up supply in the north of the State. We are also seeing that effort by the processors reflected in recent decisions to offer increases in price, albeit temporary increases, in recognition of the drought conditions. My understanding is that the imputed labour that is included in the calculations is $50,000[2] per farm.

The Hon. RICK COLLESS: You are getting to the cost of production rather than the farmgate price?

Mr RUSSELL: Yes, that is right. So I think it is absolutely true that that does not reflect the number of hours that many dairy farmers put into their businesses and we do also publish labour efficiency as part of this analysis. For example, in the north the labour efficiency figure sits at 70 cows milked per full-time equivalent and in the south it sits at 85 cows milked per FTE. There are also distinct differences in the cost drivers in the New South Wales system generally but particularly as you move north through the State. In the north of the State we are much more reliant on an annual pasture system. We do not have the same ability to use premium ryegrass that is available in the south, in Victoria and southern New South Wales, so that pushes up a range of costs, for example, energy costs. Farmers have higher farming costs because they are sowing pastures every year, higher irrigation costs and a greater reliance on annual costs, which means they are more exposed to seasonal risks that we are seeing at the moment, and very heavily reliant on imported fodder at the moment.

Mr HANSEN: In the analysis last year we have seen earnings before interest and tax in the north of around 1.1¢ per litre and in the south of around 4.2¢ per litre, so I can understand the comments that you are hearing and how they line up against those figures. But when you also have a look at some of those drivers in terms of what has eroded those earnings, pasture utilisation; in fact, the amount of imported feed that was necessary to sustain the system in the north last year was 43 per cent of the feed required needed to be imported. In the south that was 45 per cent . Not only did it increase the volume that needed to be brought in but everyone knows what has been happening with feed and fodder prices. They have been pretty significant drivers. This data is end of financial year; we can expect the first six months of this year to be a replication of that very bad last six months of the last financial year in terms of that balance.

The Hon. RICK COLLESS: What was the average cost of production figure in the north and south?

Mr HANSEN: I would have to take it on notice. We do have it.

The Hon. SCOT MacDONALD: Part of your submission goes to domestic oversupply and talks about the international prices for dairy products, its influence and impact. You are fairly clear in saying domestic oversupply is having an impact. Further in your submission you say if supply reduces to a point where the prices start going up, the processors will start transporting fresh milk. I am trying to get a clearer picture in my mind in New South Wales what that production of oversupply might look like. What are the limits; if you like, what are the triggers? Some extra money, some premium going to farm gate, and as you are indicating, it starts to fall off and processors say they will truck the milk around? Can you go into that a bit more?

Mr HANSEN: Once upon a time, because of the perishable nature of the product, the geographical regions of production were relatively isolated and therefore an overproduction in one area led to significant market crash in that area whilst others would be buffered from it. What we are seeing these days is with increased technologies, improved hygiene, handling and logistics services, there is more interflow of product across those regions and, therefore, an oversupply in one region will lead to a decrease in price in that region. But then the opportunity for that product to be utilised in other areas to both take the valve off the downward pressure in prices

[2] In correspondence to the committee dated 26 November 2018 Mr Scott Hansen corrected his evidence as follows:

I would like to correct some minor inaccuracies in values given during the Department's evidence before the Committee – Page 4 of the transcript – Mr Russell's evidence included that imputed labour was approximately $50,000 per family labour unit. The figure is in fact closer to $72,000.

in the oversupplied area but also to have an impact on prices in other areas, that might well have been either at balance or there might have been a demand outstripping supply.

The Hon. SCOT MacDONALD: Is the market—pardon the pun—that fluid, that efficient? Processors are looking around all the time at what is available and how quickly they can move product from A to B.

Mr HANSEN: It probably does not have the same degree of fluidity as some of our commodities which are basically spot market on the day because of the contracting arrangements. But there is definitely the opportunity and that fluid nature. We had an independent report commissioned, I think it was 2014, looking at the future opportunities for the New South Wales dairy industry. It flagged the significant growth in domestic milk consumption based off not only a growing population here in New South Wales—

The Hon. SCOT MacDONALD: Flavoured milk and things like that.

Mr HANSEN: And you just reflect on the changing use of milk in coffee-based drinks over the last 10 years that we have seen, and that is a significant driver. But also that increasing population base in south-east Queensland, that population hub there is continuing to grow at a fast rate as well with our northern dairy industry ideally placed to be a production hub for that. Therefore, it said the future was not necessarily manufacturing, it was in fact continuation of supply for fresh milk product.

The Hon. SCOT MacDONALD: The water market is slowly getting more transparent; buyers and sellers are knowing what each other are up to. It is getting better. Should this Committee be making any comment about the transparency of that market? I am thinking about a dairy farmer in the lower Hunter knowing pretty quickly day by day if there are opportunities in the spot market or wherever it might be, how the market is in the supply—shortfall, oversupply—situation? Are there any blockages or impediments there?

Mr HANSEN: The more transparency in the supply chain, the greater the relationship and the more opportunities that get created. No-one denies that. There is a significant volume of work being done at the moment about transparency and pricing along the supply chain. That is one that we might take on notice in terms of looking at a bit further. I think there are a couple of people post us today who will have some strong views about where that opportunity lies. So we will be watching with interest what their comments in that space are. In terms of that ability for a dairy farmer to not only have visibility but also to understand how they sit in terms of their contractual arrangements versus their neighbour, obviously when the ACCC is in here this afternoon, there have been a number of collective negotiation agreements allowed and set in place by the ACCC for groups of dairy farmers across New South Wales.

Importantly, and I guess this goes a little bit to what can we do on the transparency piece, I reflect back to the comment that the dairy industry does not really recognise State borders but more geographical production systems. Therefore, that transparency needs to be something that spreads across at least the whole eastern seaboard, which is the key production line. Because a number of the collective negotiating agreements that have been put in place are in fact not for a group of New South Wales farmers but for a group of New South Wales farmers, South Australian farmers and Victorian farmers in some cases who all want to collectively negotiate on supply of a branded milk product to a retailer. I think everything we do, especially in the price space, but even in the research and development [R and D] space, everything we do, we keep looking for where there are opportunities to remove duplication and to work collectively across State governments because that is how our commodities are produced, manufactured and consumed.

The Hon. SCOT MacDONALD: Do you see that market, whether it be regional or further east coast, whatever, becoming more interconnected? A south-east Queensland dairy farmer selling his product potentially even further afield. Is it becoming more of an integrated market?

Mr HANSEN: Definitely. More connected, more integrated, utilising each other's strengths and weaknesses, using each other's peak supply, both feed supply, cow supply, milk supply, to complement each other. We definitely see that increasing. We see the supply chains modernising and evolving as well. To be able to purchase a litre of Norco milk from a supermarket in Shanghai, that is a pretty sophisticated supply chain that can do that with such a perishable product.

The Hon. WES FANG: In your opening statement you spoke about the importance of keeping biosecurity risks at bay so that we can continue having markets both domestically and abroad. My great fear is that the model that most dairies are operating under at the moment is not sustainable. We heard testimony on Monday that the cost per litre to produce milk is vastly greater than the price received at the farm gate and that is unsustainable for any business. What would be the risks and the biosecurity risks if the New South Wales dairy industry reached the point where it was not able to produce enough milk for the markets it provides and we had to start importing milk? Do you see a biosecurity risk for the producers that are left, and does that create a risk to potential markets?

Mr HANSEN: Your lead in about the costs of production versus the milk price—and I guess it goes to a question I took on notice from Mr Colless—page 6 of our submission has the graph that reflects exactly that point that you make in terms of where cost production is, which is about $8 per kilogram of milk solids, versus what the milk price is and sits at the moment. At the end of the day, we can take great comfort in the food safety standards and the work that our food authority does around the inspection and the licensing and accreditation of everything from farms, milk transporters, processing, stores, manufacturers and even food transport vehicles. We rely on the Federal Government in terms of its checking of compliance of any imported product, that they meet the standards that are set for the country, both from a food safety and a biosecurity point of view. Obviously, the more imports and the more, either people products or containers or shipping, packaging that comes into the country always increases the risks, the numbers in terms of that. It increases our need for vigilance at all of those points of entry as well as vigilance from our Federal Government in terms of governments of any exporting country ensuring that their exporters maintain the standards that we expect our industry to maintain.

However, I still hope that we never get to that point and that there is strong demand and strong support for not only Australian-produced milk. More and more, our consumers are looking to the problems of the milk to select from regions or from areas that they have an affinity with or that they live in close proximity to. We think that is a very strong angle for our dairy industry to continue to promote itself and its products to the customer base here to stay sustainable. However, energy prices and water prices have been increasing regardless of the season we have just gone through. That is where we need solutions in the innovation and productivity space.

The Hon. WES FANG: While you said efficiencies can always be found, the testimony to the Committee is that the majority of farmers believe there is not much more fat to be cut. To make more productivity gains, they would need to be making a good return on their investment to be able to invest in further productivity measures. How are farmers supposed to be able to increase productivity when they are receiving less for their product than it is costing to produce? There is nothing left for them to invest in those productivity measures.

Mr HANSEN: If you look at that the graph in terms of cost production and milk price, they have been running close to each other for a fair while. I agree. Our 2017-18 figures indicate that the average return on assets is about 1.2 per cent. The point about the opportunities for investment in new infrastructure, new genetics, new technologies or new systems is well made. However, at the moment I think we have 32 dairy farmers in the State who have utilised the Government's farm innovation fund to access capital at a fixed low interest rate, subsidised by government, to enable them to get new technologies, new equipment, or new drought mitigation or seasonal mitigation technologies in place. But that is 32 out of 660[3] dairy farmers in the State.

One of the big challenges they face is being able to make sure they have a viable business model to enable them to source the capital funding they need to make some of those changes and efficiency improvements. When we talk about productivity and efficiencies, we are not talking about just stripping costs out of the system, because there is very little fat left. This is about the next big breakthrough in terms of the genetics of the cow to help increase production volume off the same inputs. What are the next big breakthroughs in terms of the stability of the fresh product to enable even further distribution and to reduce supply chain costs in that process? All of those pieces are part of that; it is not just about removing current costs from the system.

The ACTING CHAIR: The Chair has been keen to pursue the idea of a milk commissioner. There has been some dialogue around the need for a milk commissioner's office or something like that. I note that on the last page of your submission you talk about the Australian Competition and Consumer Commission and options for Commonwealth intervention. One suggestion is the establishment of an independent body to arbitrate contractual disputes and to handle dispute mediation clauses in contracts. First, what is the department's view about a milk commissioner or a similar office? Secondly, do you think that office could play a role, for example, as an independent body to arbitrate contractual disputes in the industry?

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Mr HANSEN: Starting from the premise that I commented on before that dairy production systems and dairy supply chains do not recognise State boundaries but operate across them, whatever happens in the market imbalance intervention space—I note that the Commonwealth is now undertaking consultations about a mandatory code of conduct for the industry—must happen at a national rather than a State level. We do not want to create an environment in which anyone in the supply chain feels that there is a downside risk in dealing with a State versus dealing collectively with all of the States. That being said, we took great heart from the appointment by the ACCC of a dedicated agricultural commissioner. That role is still relatively new; I think it has been only two years or 18 months that it has been in place.

I note that the ACCC has been consulting relatively recently—I think the process closed in September—about the potential of different approaches to different negotiating approvals rather than looking at individual businesses or groups of businesses and categorisation of businesses. A number of those vehicles might provide some tools to help with arbitration and collective negotiation to address the imbalance. We are watching closely and are keen to see the views of the dairy farmers and their supply chains through that Commonwealth consultations and through this committee's consultations. We are constantly looking at how to reduce our supply chain costs. If someone were proposing to insert a government cost into the supply chain, we would want to know that it would create greater value than the costs being inserted. We must constantly work out the best approach and what value it would create as opposed to the cost it would impose before we can make a call as to the value of such a commissioner.

The ACTING CHAIR: Is the department doing any work on the opportunities and also the potential impacts of the Trans-Pacific Partnership [TPP] agreement on this State's dairy industry?

Mr HANSEN: I note that Dairy Australia has been doing a lot of work collectively for the dairy industry in its trade and market access group around the impact and opportunities offered by the TPP. We have not dedicated any resources to looking at that specifically. We have just been making sure that we have been providing input and collaborating where needed with Dairy Australia.

The Hon. JOHN GRAHAM: I will pick up on that discussion about the requirement for a national approach, which you have referred to and which the Government submission mentions. I am interested in what is the forum and how the New South Wales Government or the department plug into that national discussion? Given that is the view you are putting, how do we advocate for Commonwealth action on that set of issues?

Mr HANSEN: The fact that both State and Federal bodies are talking to their respective industries collectively—one talking nationally and one talking at the State level—around this topic means there will have to be a coming together of the collective findings of those consultation rounds at some stage. This is a much broader topic of discussion than the narrow code of conduct discussion. We would be ensuring that our Federal counterparts were aware of and had access to the submissions on this Committee's website. I am sure that a number of those who prepared submissions to this Committee would use them for the Federal consultations. I am not sure what the timing for this Committee's report is going to be—

The Hon. RICK COLLESS: Shortly.

Mr HANSEN: —but we are happy to work out how we make sure the outcomes from here and Government's consideration of those can be fed into discussions that the Federal Government will be having as well in a short time frame around what it does with its code of conduct because it does come back to it is not just in that price or market intervention options piece. Even on our research and development piece, the industry has told us for quite a number of years now that they do not want to see States competing against each other to win research contracts to repeat research across different jurisdictions. We have a forum in which we collectively work on, who is doing what pieces of research for the dairy industry between Victoria, between New South Wales—

The Hon. JOHN GRAHAM: What is that forum?

Mr HANSEN: That forum is the Agricultural Senior Officials Committee.

The Hon. JOHN GRAHAM: There are two lots of dialogue with the industry. This Committee might play a role. What is the agency channel where you press this case? You are saying, "This really requires national action". Where does the New South Wales Government put that case to the Commonwealth? Are you at the table for that?

Mr HANSEN: We are at the table for the discussions and the consultation. We will not be at the table when they finalise what they want to do, but we will then be at the table when they come out to inform and consult and look at options.

The Hon. JOHN GRAHAM: Where do you press the case? What is the forum where you put that case to the Commonwealth on behalf of the Government?

Mr HANSEN: It will either be the agricultural senior officials or it will be just literally through our conversations on a daily basis with the Commonwealth about what we are doing here and what they are thinking about.

The Hon. JOHN GRAHAM: How would you characterise those discussions today? Are they active at the moment, pressing this case about the need for national action on the recommendations that have been identified, or are you waiting while the consultation rolls out?

Mr HANSEN: They are still very much in the listening to the industry as they go around with consultations.

The Hon. JOHN GRAHAM: When do you see that discussion really heating up?

Mr HANSEN: Probably at the end of their consultations. I do not have that time frame in front of me.

The Hon. JOHN GRAHAM: The other set of questions I wanted to ask is about the market outlook, acknowledging the view you are putting today about the importance of the international price. I was interested in the department's view about what is the price and market outlook in the medium term internationally, acknowledging we are already the fourth largest exporters—that is a pretty powerful place to start when it comes to dairy products. What information does the department have about the medium-term price outlook, given the significance of the international price?

Mr HANSEN: I might see if Mr Russell has figures, because one of the questions we ask our farmers through the farm monitor project is about what their views about forward pricing and forward demand are. I know that it was a relatively split view around prices either holding or improving, or whether they would decrease. I know we have the numbers. I just do not have them right here in front of me.

Mr RUSSELL: In fact, I think 65 per cent of the farmers surveyed felt that prices would either remain the same or decline. There is quite a pessimistic outlook about the dairy industry situation at the moment. We do not have any information to hand to suggest that global prices are going to increase significantly.

The Hon. JOHN GRAHAM: This point about where the international price is heading is obviously fundamental to the optimism or otherwise of the industry. But you are really saying that Department of Primary Industries [DPI] relies on the farm estimates. We are not bringing that information to the table at any point. It is really driven by the farm expectations, given they have more information about where that dialogue is up to. Is that the case you are putting?

Mr RUSSELL: Dairy Australia publishes information about its price expectations and the global trade figures are reported by Dairy Australia. I do not have those figures to hand at the moment, I am sorry, but that is the best information. I guess we are quite interested in farmer sentiment as well because that reflects the mood of the industry and how people are feeling about their futures in the industry.

The Hon. JOHN GRAHAM: The Government submission outlines two potential actions where we could provide more assistance. One is about New South Wales Government connections being used to explore options for more direct export to markets such as the United Arab Emirates and Malaysia. Is that something this Committee could recommend be stepped up? Is that a potential lever here that could be used and is not?

Mr HANSEN: I think there is more that we could be doing in the space of encouraging and facilitating trading relationships between specific countries and our exporters. We have a real advantage on this front because in mostly international trade space brand Australia gets you access into the marketplace and then your own commodity brand or your product brand is what gets you your customers and your loyalty. The advantage we have is that when most people think of Australia, they do think of New South Wales. They might not know it as New South Wales but they think of it as Sydney. We have the opportunity to continue to play off that and create opportunities for our exports in those marketplaces. At the same time, we have an industry that is keen to grow those opportunities.

The Hon. JOHN GRAHAM: What would it take to make that happen? What do you need to make that happen?

Mr HANSEN: We continue to need to invest in our trade counsellors around key growing markets. We need to continue to support appropriate delegations into those marketplaces to form those relationships and to maximise the opportunities.

The Hon. JOHN GRAHAM: The second action was to facilitate the process for export accreditation for some processes. It is the same set of questions. Do you see this as a key lever—what you need to do?

Mr HANSEN: We have made quite some progress on that in recent times. We have been able to sign a memorandum of understanding with the Federal Government to enable our food authority inspectors to carry out inspections of New South Wales milk-processing facilities for export, therefore reducing the duplication between the audits we were doing for the purposes of the domestic market and the audits it was doing for the purposes of the export market. That creates additional opportunities for us to encourage other processors to be able to step into the export market space and to ensure that they are meeting the standards that are required by those importing countries.

We do not have a role at that table of the opening up of the protocols between Australia and those countries; that is with Federal Government. What we do have a role in is in bringing our technical expertise to ensure that there are no practical barriers to that trade; it then just remains political barriers. That is where we can continue to work to help the Federal Government in its negotiations.

The Hon. JOHN GRAHAM: The final thing I want to ask almost picks up from the TPP point. Looking at the markets we are exporting to—China, Singapore, Hong Kong, Taiwan and Vietnam—does the department have concerns, or are you getting feedback about concerns, about a possible trade war involving the region? How concerned should we be about that gathering discussion impacting on our dairy farmers in this State? Is that a concern or is it not?

Mr HANSEN: It is something that we should be watching for, but it is not something yet that we should be putting in the "concern" basket. Australia has a strong reputation in that list of countries and in the TPP countries. In fact, Australia has been talking to and dealing with many of those countries on a bilateral basis well before the multilaterals were approached. We should always make sure that we continue to position ourselves as strong bilateral partners, not just multilateral participants. Our brands, our reputation—we have made an art form of turning some of our competitive disadvantages into our competitive advantages.

We have used our isolation from the rest of the world, and hence our distance to market, a strong advantage around our biosecurity barriers. We have been able to utilise our clean, green production systems, which often are higher-cost production systems than many of our intensive industry counterparts in Europe or North America, as part of our story and provenance telling. We have a strong standing and a strong reputation. We have a strong bilateral relationship. It continues to create opportunities to this point in time but we should never be complacent about it. Your point about potential trade wars, we should always be monitoring for.

The ACTING CHAIR: Can you give us a bit of an overview of the industry—I am not sure whether the department has this—with the number of dairy farmers and their operations. Are they husband-and-wife teams? Are they multinational corporates? What is the average age of those operations? I guess I am trying to get a feel for it. If the average age is getting quite old is it an industry that may be at risk of collapse at some point in the future because you do not have people coming in? Are their new entrants coming into the industry? Does the department do that sort of work? Are we keeping that sort of analysis?

Mr HANSEN: I might ask Mr Russell if he has any figures in front of him. Collectively across the country—including by us—there are statistics and figures collected on dairy farm operations. As I said, we continue to have high demand on our dairy farmer training courses, through Tocal, which is a good sign that there is active interest in the next generation being trained and participating in the in-house and block training programs that we run in conjunction with the dairy herd there. I do not know if Alex has any figures to hand in terms of the demographics.

Mr RUSSELL: I do not have figures about demographics, but I can make a few comments about the sorts of changes that we are seeing generally. Certainly there are a number of corporate players in the dairy industry. The most significant one in New South Wales started out as a family concern. We are also seeing a trend towards larger herd sizes. With that comes a requirement for increased employment of labour on the farm outside of the family. The current circumstances, anecdotally, are driving dairy farmers to greater utilisation of family labour in an attempt to reduce costs. But more generally, across the years, we are seeing an increased requirement for labour in the dairy business because of the increasing herd size.

We do a number of things to try and help with both the upskilling of young dairy farmers coming into their family businesses, as well as upskilling labour coming in from outside. There is an initiative called the Young Dairy Network. It is a Dairy Australia initiative—a national initiative, but it is one that the department supports in New South Wales. There is a project that has been funded by the Dairy Industry Fund, which is looking at identifying and improving pathways for people coming into the dairy industry—either the younger generation or outside labour. We see that an important thing for the department to do is to support that upskilling of people coming in, either as the next generation or as labour from outside.

The ACTING CHAIR: My last question is to do with the drought and the drought package that has been rolled out. How closely does the department monitor the effectiveness of the drought packages, particularly for the dairy industry, and what is the feedback that you are getting?

Mr HANSEN: We can tell you that about 20 per cent of dairy farmers in this State have applied for the transport subsidies. That has probably been the biggest key component for them, to try to reduce the cost of transport to offset some of the increased cost of fodder that has been felt across the State. As we said, we have 32 farmers who have also taken just under $7 million in the low interest loans to help with drought mitigation. So we continue to get strong feedback that the combination of those subsidies and the loans and the removal of the Local Land Services rates or the waiving of the LLS rates for this year, water licence fees and those activities have all been beneficial. In terms of it being able to offset the overall costs of what this season has presented you can see by the figures that there is still a significant cost that farmers are wearing because of the seasonal conditions across the whole of the State.

The Hon. MARK PEARSON: Mr Hansen, you said that when there have been situations in areas where there has been an oversupply of milk it has had a critical effect on the pricing. But then you said that because of integration it has taken the valve off that particular problem in that area where there is an oversupply. Can you explain how that has happened?

Mr HANSEN: I guess that that is just a reflection of the fact that, with our hygiene standards, our food transport standards, and the logistics changes that are now in place fresh milk is not as geographically isolated as it once was. It is hence able to be transported to fill holes in other markets if their supply is in some—

The Hon. MARK PEARSON: Right. That has clarified it. Mr Russell, at what point does a typical dairy become an intensive dairy, and what factors are brought to bear on a dairy to move in that direction?

Mr RUSSELL: Thank you for the question. I think it is quite difficult to define a particular dairy as being intensive or otherwise. I guess the thing about dairying is that it requires a really high level of management input. For me that is what defines it as an intensive production system—the fact that it requires that high level of management input. There are different production systems in Australia. Some of those involve what we call a partial mixed ration production system or a total mixed ration production system. That reflects how much time the animals spend on pasture compared to being fed from a trough, say. But, really, I see it as an intensive industry because of that high level of management input that makes it quite challenging.

The Hon. MARK PEARSON: It is not because of the amount of space—the stocking density—it is more a matter of the intensity of the work by people. That is how—

Mr RUSSELL: That is my view. And the inputs that are provided. So the less time the animals spend on pasture the more there is a requirement to cut and conserve forage and bring that to the cattle or to spend money on buying inputs—grain and fodder.

The Hon. MARK PEARSON: I think there was a period of time—I do not know whether we are still doing it as much—where we were exporting dairy cattle as breeding stock, mainly to Asia and I think perhaps to the Middle East. Is that continuing. If it is, is it having an impact on the economics of the dairy industry in Australia, in terms of our exports of dairy?

Mr HANSEN: Not at the same rates as in previous years but there continues to be a high-end value dairy heifer air shipment into Asian markets that are looking to grow their own genetics and their own herds. Some of the speakers after us might be better placed to talk on that front. What we are seeing, though, is a significant increase in the integration between dairy operations and the meat operations in terms of the opportunity to supply calves into beef production systems. That is largely because we have seen, exacerbated by the last 12 months, a significant reduction in the national herd whilst there is incredible demand for meat globally, continuing to grow.

Dairy farmers, while focusing on the purpose of producing milk, obviously have opportunities with the animals they are producing in terms of the meat industry as well as the fodder they are producing in terms of that fodder being a potential source of income if they are able to produce surplus to requirements. In the last 12 months that has not been the case. Dairy farmers are very good at looking at that business integration and looking how they maximise the resources they have available to them to make their businesses as sustainable as possible.

The Hon. MARK PEARSON: So, the export of dairy breeding stock is not having a serious impact on the economics of the dairy industry nationally, as opposed to—

Mr HANSEN: The alternative sources of income into our farm monitor project figures suggest that it is not a significant driver in terms of the profitability. However, that fails to take into account that for certain businesses at certain times that could well have been a defining moment, or an opportunity that has enabled them to earn income that otherwise they would not have been able to. So for individual businesses you can only assume that there are some that are very thankful and have been reliant upon that additional income source, but when you look at it collectively it is a small proportion in terms of farm-gate income.

The ACTING CHAIR: That draws us to a close. Thank you, Mr Hansen and Mr Russell, for your attendance this morning. I believe you took a couple of questions on notice. The Committee has resolved that you will have seven days to get those back to us. I know it is pretty prompt, but the Committee has a short reporting time frame. The secretariat will contact you in relation to the questions you have taken on notice and the manner in which you can get the responses back to us. Thank you very much.

Mr RUSSELL: Thank you, Chair.

Mr HANSEN: Thank you.

(The witnesses withdrew)

ASH SALARDINI, Chief Economist, NSW Farmers Association, affirmed and examined

COLIN THOMPSON, Vice Dairy Chair, NSW Farmers Association, affirmed and examined

ANNABEL JOHNSON, Policy Director Livestock, NSW Farmers Association, affirmed and examined

The ACTING CHAIR: Thank you for your attendance today and for your submission. Would any of you like to make a brief opening statement?

Mr SALARDINI: We have a couple of opening statements.

Mr THOMPSON: Thank you. I would like to make a statement.

The ACTING CHAIR: Yes.

Mr THOMPSON: NSW Farmers welcomes the opportunity to provide our dairy farmer members insights into the current conditions of the New South Wales dairy industry, and the role of government in supporting the industry to build a strong, sustainable and productive New South Wales dairy industry. NSW Farmers is the largest State farming organisation in Australia and represents the interests of all primary producers, with our dairy members being represented through our Dairy Committee. The dairy industry in New South Wales is unique, given its diverse geographical spread and associated environmental conditions. At present, dairy farmers in New South Wales are facing several challenges.

Concerted action is required to ensure the ongoing sustainability of the industry. The New South Wales Government has an important role in supporting and growing the New South Wales dairy industry by investing in areas to facilitate growth and developing policies that support farmers businesses. The structure of the New South Wales dairy industry has undergone a dramatic shift since deregulation. Australia's milk production in 2002 was 11.3 billion litres. Production generally has trended down since that time and is estimated to be 8.8 billion litres, which is the lowest in more than 20 years. It represents a 22 per cent decrease in 16 years. Politicians should be concerned when the production of an important food commodity such as dairy is decreasing at a time when population is increasing.

Historically, as the number of dairy farms decreased, the remaining farms grew in size and production and often more than compensates for the loss. However, this is no longer the case, with farms exiting the industry quicker than those remaining can increase production. In 2000 New South Wales had 1,725 registered dairy farms. Today there is a little over 600 left. While there are many reasons for farmers to exit the industry, the overwhelming one, particularly in recent years, is financial unviability. Put simply, milk prices have remained static for far too long while costs have continued to increase.

New South Wales is predominantly a "liquid milk state" where around 60 per cent of milk produced is use for drinking milk. Traditionally, the premium this year-round supply attracts is what made dairying possible in New South Wales. Higher costs associated with milk production in this State include a warmer and more humid climate, a less reliable water supply, greater transport cost for both feed and milk to the Sydney market and an industry spread over a large area. This white milk premium has been eroded over the years and particularly over the last seven years since the major supermarkets have heavily discounted the retail price of whole milk, removing millions of dollars from the supply chain—not only through the discounted private label but also through the reduction in price of the branded milk.

The discounting of white milk is having not only a devastating financial effect on farmers and their families but also a psychological one as farmers, who are struggling to cope with a crippling drought, see their high-quality product devalued in such a way, used as a loss leader, and sold cheaper than bottled water. Australian dairy products are highly regarded and trusted around the world, renowned for our efficient production systems, our clean green image and food safety that is second to none. Export opportunities continue to grow—however, all to no avail as production continues to decline.

I have just noticed that this inquiry is largely focused on the coastal strip or dairies on the eastern coast and I would like to draw your attention to what is happening west of the Great Dividing Range, which is probably one of the only places in Australia where the industry is actually growing and has great potential to grow. I grew up on a small coastal dairy near Bega. In partnership with my parents and my wife, we produced around 700,000 litres. In 2000 my wife and young family and I relocated to Cowra to a green field site and built there a 320-cow free stall dairy facility producing around 4.5 million litres annually.

We have adopted the very latest in dairy technology and methods. We have increased individual cow production to almost three times the national average. Even with this highly efficient system I have grave concerns as I see production costs increasing at an alarming rate while milk prices are artificially distorted though needless and senseless retail discounting. Dairy in New South Wales is in crisis and urgent action is required to address the market failures that are crippling our important industry.

Mr SALARDINI: I would like to quickly make a statement on competition that will take about a minute. Basically, dairy farmers find themselves in the valley of death from a competition and bargaining power perspective. Farmers find themselves as price-taking and dealing with large powerful stakeholders for their inputs and their outputs. Farmers have to deal with monopoly or oligopoly providers for their water, electricity, farm supplies, finance and freight solutions. They also sell their goods to powerful monopolies and oligopolies, depending on which geographical location they are in.

Uneven power dominates every business relationship for a dairy farmer, and often this power is abused. Very recently we have had absurd situations where farmgate milk prices were adjusted retrospectively. Can you imagine that happening in any other industry or in any other context? Imagine you going to a retail store and you buy a television and six months later Harvey Norman phones you and says, "My costs have changed. Your TV is now $100 more expensive." That would not happen. At the head of these supply chains sit supermarkets. By any measure, including a recent report by Grattan, we have the most concentrated retail supermarket sector in the world. They have used their power to squeeze all the margin in food supply chains, and unfortunately farmers, due to their lack of bargaining power, bear the brunt of this squeeze.

We need to divorce issues around competition from issues relating to drought—they are separate issues. All this drought has demonstrated is how close to the edge farmers have been operating due to being squeezed by powerful stakeholders. The drought merely demonstrates how the financial resilience has been sucked out of the sector, particularly dairy farmers. Similarly, we need to divorce issues around deregulation and competition police. Deregulation has not necessarily failed farmers; competition policy has. Despite having one of the most concentrated supermarket sectors in the world, the number of compliance and enforcement actions should sound some sort of alarm for people. I understand that this is a Federal issue, but there are some steps that can be taken at a State level. There are actions that the New South Wales Government can undertake, including the establishment of a office of the farmer advocate. We hope to tease this issue out more during the session. Thank you.

The ACTING CHAIR: I am going to lead with questions. I want to pick up on Mr Salardini's comment on the proposed office of the farmer advocate. There has been some dialogue in this Committee about the need for a milk commissioner, which is a very similar role—in fact, it is probably a more succinct role than the one you are talking about. How would you see the Office for the Farmer Advocate operating? What would its responsibilities be; where would it reside within government structures; and how would it work?

Mr SALARDINI: The first point is to highlight what the problem is. We have a competition framework that is reliant on the regulator to enforce. Either through a lack of will, a lack of resources or a lack of priority, things like the abuse of market power or anti-competitive behaviours are not the bread and butter of the ACCC. If you go through their annual reports you will see that what it loves is deceptive and misleading conduct, because it is a very easy thing to do. The evidentiary burden is there for all to see. There is a failure there. The next step is that by the very nature of the type of problem we are talking about, the people being affected by it do not have the power to take on those large powers. If a farmer decides to take on a supermarket or a processor and take them to court there might be an adverse cost order made against them that could run into the millions of dollars. I do not know any farmer who has that kind of money or financial wherewithal to take a processor to court. We have a competition policy framework that more or less does not get tested.

Periodically there is an investigation, but they usually happen when there is an absurd situation. For example, that absurd situation with the dairy industry with retrospective pricing. It took something as absurd as that before the ACCC acted in the dairy industry. Now we have the dairy review and there have been some recommendations around mandatory codes. What I would suggest is that the farmer advocate investigates, on behalf of New South Wales farmers, issues in the industry, whether they concern dairy, poultry or pork, and looks at whether there is an issue. I will take it one step further and suggest that they could act as an advocate and run test cases. That would change the game a lot because there would be a testing of the provisions of the competition laws within the agricultural sector. That, dare I say it, would change some behaviours within the processes, within marketers, and within retailers such as supermarkets. That is broadly how we see the farmer advocate working. It is difficult to say where it would sit. You have a Small Business Commissioner but it might sit it in the Attorney General space within the government structure. We have not really thought that through yet.

The ACTING CHAIR: Is it best suited to be sitting with the Department of Primary Industries or should it be completely separate?

Mr SALARDINI: It would probably need to be independent. Where it sits is probably not as important, as long as the commission or advocate is an independent body with resources to take action—for example, running test cases and running investigations. That is what is sorely missing. Obviously, we are making the same lobbying effort at a Federal level for the ACCC to be more active in this space, but that is pushing something up a hill, basically. Given its very restricted resources, the ACCC will always focus on things such as misleading and deceptive conduct.

The ACTING CHAIR: Thank you. Mr Thompson, in your opening statement you spoke about the absurdity of the retail price and the milk wars that took place between the major retailers. What was the impact of that on the ground for dairy farmers?

Mr THOMPSON: As I said, there was definitely a financial impact. There is no question that if millions of dollars are taken out of the supply chain the loss will flow through to farmers. It has had quite an impact, despite the findings of the ACCC review. It has had a significant financial impact on farmers. Also, it has had quite a psychological impact on farmers to see their product devalued. It was not only milk, but also cheese and products across the dairy cabinet. They have seen their product devalued. Farmers know that when they go to the processors and try to negotiate a better price each year, they will hear the same story. The supermarkets are just squeezing our returns. There is no more money. Farmers are at the end of line, as always. We are price takers and we get what is left after the supermarkets and retailers, who have artificially distorted the market.

The ACTING CHAIR: The other issue I would like to explore with you is your input costs. For instance, earlier in the year, I met with some dairy farmers at Wallarobba up near Dungog. They spoke about the complexity of the contracts they sign for electricity with the local electricity providers and trying to understand those contracts. That is obviously a substantial input cost. What is happening with your input costs and is there anything that this Committee should be looking at with regard to that?

Mr THOMPSON: The Committee should understand that the input costs, such as electricity, are something that we have no control over. Dairy farms use a lot of power. We have to harvest our milk, we have to cool our milk and we have to pump water. There is no other way of operating our businesses other than to use power. I am in the process of renegotiating our power this year and, coming off a three-year contract, we are seeing an 80 per cent increase in the cost of power. Other input costs at the moment are being affected by the drought and farms are having to pay much higher costs for feed. Again, we have little control over that. Farmers generally—and particularly in New South Wales—are locked into a system where we supplement pasture or fodder crops with purchased concentrates and we are seeing those prices more than double at the moment. Farmers are struggling to pay their bills.

The Hon. JOHN GRAHAM: I want to ask about a couple of things in the submission. You have called for a New South Wales dairy industry plan. The New South Wales Government submission puts a view about the strategic action plan, which is in place at the moment. What is the difference between what you are calling for and what is in place from 2016?

Ms JOHNSON: The 2016 plan is an excellent framework but the problem with it is that it has not been well tracked in terms of progress. Stakeholders have not been held to account, including both industry stakeholders and government stakeholders, on their roles and responsibilities and delivering on them. Because of that lack of action, we think that now is the time to revisit that to look at what the new opportunities are and whether that plan, which was very much focused on growing, is still the direction in which the industry needs to be heading. We need to make sure that there are clear time frames on delivering and that there is a process around governance so that the actions are reported and there is a tracking back to farmers so they can have faith that the plan that was agreed to is going to be actioned and drive the industry.

The Hon. JOHN GRAHAM: You do see this as building on the existing plan?

Ms JOHNSON: Absolutely. And there has been a number of plans. There was the Fresh Agenda, which was completed in 2014 and there is work that has been done at the national level by Dairy Australia, which we see as feeding into this. We just see that there is a lot of activity at the moment so the point of that recommendation was really just to highlight that the role of government within that activity needs to be driven by this Committee.

The Hon. JOHN GRAHAM: But we need clear accountability; we need to know who is doing what and when?

Ms JOHNSON: Yes.

The Hon. JOHN GRAHAM: That is really the gap at the moment?

Ms JOHNSON: Yes, and to have ongoing planning.

The Hon. JOHN GRAHAM: Would it have a different scope to what is in the existing 2016 plan or are you comfortable with the scope of that?

Ms JOHNSON: That one was very much focused on growing the New South Wales industry. I think the one we are looking at would look at a more sophisticated understanding about how New South Wales interacts with the other milk pools and how we produce a sustainable New South Wales industry that is going to be profitable and productive into the long term. As Mr Thompson highlighted, a growth area is the central inland area so focusing on that area and what is that plan?

The Hon. JOHN GRAHAM: Thank you for that. On the competition issues, I find your sketch of power relationships in the industry pretty powerful, and I accept that, except for this: the ACCC is saying really: All that might be true but the price is being set internationally; that is the key market driver here. Do you disagree with that conclusion by the ACCC?

Mr SALARDINI: Very much so, and I will just preface this because we have been dealing with the supermarkets and now they have been holding that ACCC report like a shield and saying that it has absolved them from all responsibility and they are really using it as a very powerful shield—

The ACTING CHAIR: You should be aware, Mr Salardini, that we are trying to get the supermarkets to come to the inquiry.

Mr SALARDINI: Just say lost leader and they will come and try to correct the record; say lost leading milk and you will get them all here lining up here to correct you. If you want to send a letter out to them, I can draft one to help you along. One thing I will say about the regulator is they are like a frog in boiling water. Look at the Australian Energy Market Operator, which regulates the energy market nationally and look at the Independent Pricing and Regulatory Tribunal [IPART], which reports on it at a State level. Since about 2012 both of them, year-on-year, have been saying that the national energy market has been working fantastically well for consumers and meeting all competition outcomes as would be expected from a competitive market. Lo and behold we have a crisis and in 2017 the market is terrible and everything is wrong with the retail market for energy, both from a generation perspective and a retail perspective. Regulators get it wrong and they get it wrong often is the first point I would like to make.

The Hon. JOHN GRAHAM: I note that IPART says that your power price, Mr Thompson, are going down at the moment so I am open to this line of argument you are putting. The ACCC has done some pretty rigorous work in other areas so your claim is not to be taken lightly?

Mr SALARDINI: No, not at all.

The Hon. JOHN GRAHAM: But how do you justify this?

Mr SALARDINI: The first point I would like to make is that one of the key points from the ACCC recommendations is that there is no difference between the margin for the farmer on branded and non-branded milk because we have structured it such that we take the heat on the margin from branded and non-branded. That is a furphy because we agree that the price at the farm gate for branded and non-branded milk will be exactly the same. That is a different issue because when a farmer squeezes the teat of the cow, they do not squeeze one into a branded bucket and squeeze another one into an unbranded bucket. The average price comes down—this is really basic economics. If there is less margin in the whole supply chain, it moves up and down that supply chain.

The fact that they are only getting nothing, according to their own—not nothing but 1¢ maybe of profit on their unbranded milk yet on the branded they are getting quite a bit is a bit of a nonsense. Everyone works on averages and in fact supermarkets work on the basket of goods. Whatever great consumer outcome you are getting on milk they have got it back on the Kit Kat. That is the first point I would like to make with the ACCC and the claims they make there. The other one is that there is a slight difference between fresh milk and other dairy products. Yes, there is an export market with other dairy products such as powder milk and skim milk and that largely sets the price there. With fresh milk there is a slightly different set of dynamics and it is not necessarily beholden to international markets.

The Hon. JOHN GRAHAM: So you do not accept that the international price is the key driver of fresh milk?

Mr SALARDINI: Not particularly, no because fresh milk is not exported. There is some interplay; it is a variable but to suggest that it is the only variable and it is the predominant variable—

The Hon. JOHN GRAHAM: Well, you have covered a range of things there. Do you accept that it is the predominant variable?

Mr SALARDINI: No, for fresh milk. Everything else is exportable. The final point I would like to make is the price is not the price and there is not this market god that sets the prices. This notion that the market has set the price for milk at $1 a litre is absolute nonsense. In fact, prior to Coles deciding to differentiate and using it as a loss leader or least profitable leader, as the supermarkets would like us to say, milk was $2 a litre or close to $2 a litre and everyone was happy to pay it. It was through their marketing that actually changed the notion of what consumers expect to pay for milk.

The example I would give is that it is all about marketing. Another example is with eggs. Free range eggs were not something that consumers asked for. The market does not decide these things. The supermarkets decided that there is a differentiation in the marketing exercise there that will get people into the door and get them to pay a higher price for eggs, hence all of a sudden they have become great corporate citizens in organic and free range eggs are all the go and caged eggs are bad. That is through a sustained marketing activity. This notion that the price of milk is magically set and consumers decided it is $1 a litre is not necessarily true.

The Hon. JOHN GRAHAM: I ask a final question on the third topic, which is about the role the New South Wales Government or DPI can play, pursuing those transparency issues, those recommendations of the ACCC, which have been set out, that the New South Wales Government says are important. What role can New South Wales play? Firstly, do you accept that is an important agenda to pursue and what can New South Wales do to push that along because it is one thing to say, "Look, this has got to be dealt with nationally"; it is another thing to accept the responsibility that we have to help to make that happen. What do we need to do in that space?

Ms JOHNSON: New South Wales is supportive of the eight recommendations that the ACCC laid down. They are focused on the processor-farmer relationship. We detailed in that submission that this is an area that is of concern. What the Government can do in that space is that farmers will need support in understanding their contracts and the code will set the minimum standards about what is required. The code could dictate that everybody needs to have a contract. Farmers need to make sure that their contract is signed before they start dealing with the processors. There will be a huge education campaign to make sure that whatever the code, which is currently out at consultation—that everyone is meeting that standard. Government and industry need to work in partnership to ensure that we get to that level, especially looking at how quickly the code is being developed. It is something that both industry and government should be proactive and starting to plan for now.

The ACTING CHAIR: Mr Salardini made the comment in his opening statement about deregulation of the industry and competition policy. Often they are conflated when one talks to people and you quite cleverly separated the two. There has been testimony to the Committee around the potential need to re-regulate or partially re-regulate the dairy industry. I am keen to hear NSW Farmers' views around that?

Mr SALARDINI: I do not think we have a strong view. The point is that with deregulation what was sold to farmers was that we have a robust competition framework that will protect them from the excesses of other players who have market power. In the absence of that they have been left exposed. The advent of the deregulation has actually hurt farmers but that is more to do with the fact that the competition regulator has not really picked this up. I do urge you again to look at the egg sector and look at the types of actions they have taken. In fact, I think farmers are over-represented in that action versus the processors or supermarkets because there has been misleading and deceptive conduct around things like store-free—

Ms JOHNSON: There have been a few cases around free range eggs and what that indicated before the development of the national standard. That was what kicked off the development process around that.

Mr SALARDINI: The processes failed farmers. If we cannot figure out another process, then let us look at re-regulation but we are not there yet. In principle, we have a very good competition policy framework. I dare say there are bits missing, including fairness, and if you look into the European Union, one key principle in the European Union's competition framework is around fairness within business dealings and within relationships, so we have a good framework. It could get a little bit better but it is the enforcement, compliance and implementation of that framework that is missing and unfortunately that has left particularly dairy farmers a little bit high and dry with the cessation of deregulation.

The Hon. MARK PEARSON: Are you saying that if the ACCC looked at evaluating or investigating the economics of the dairy industry, just looking at fresh milk as opposed to dairy in terms of its sustainability, then it would have had a different outcome?

Mr SALARDINI: That report seems to say a few things. They make some reference to that in the report, that fresh milk has slightly different dynamics to areas where there is powdered milk.

The Hon. MARK PEARSON: You are saying the outcome would have been quite different?

Mr SALARDINI: Would be slightly different, yes.

The Hon. MARK PEARSON: Slightly.

Mr SALARDINI: Within certain geographies. In southern New South Wales and Victoria, not so much. The further away you go from there, yes, it would make a big difference. The other point I would like to make is I think it missed the first step of what a regulator does, which is to define the market. Is it a market for dairy? Is it a market for fresh milk? What geography are we talking about? Because all milk does not go everywhere. There is a limited distance you can move milk around as well. The fact that they looked at it on a very grand scale geographically as well, is another shortcoming of that and you would come up with slightly different results. That is why I say potentially the recommendations would hold almost wholly for places like Victoria and the southern parts of New South Wales, but outside of that I think the further you move away from that your results would get a little bit different.

The Hon. MARK PEARSON: Do you think it would be a different outcome if the ACCC, rather than look only at misleading or deceptive conduct, look at fair conduct?

Mr SALARDINI: That would make a big difference.

The Hon. MARK PEARSON: Or fairness, like the European Union [EU]?

Mr SALARDINI: Yes, I think that makes a huge difference. Because, let us say between the processors and the supermarkets Colin's margin is squeezed 99 per cent and there is 1 per cent left for Colin, so he does not go out of the market. Then the supermarket passes 1 per cent of that 99 per cent that they have gouged to the consumer. From a competition perspective that is completely fine. The consumer is better off by 1 per cent. It is not there to protect or be fair. If you can prove there is a misuse of power or some sort of anti-competitive behaviour, yes. But if it is just done through sharp practices, because I have nowhere else to sell, that is fine, that is completely within the bounds of where we have it. If you have a fairness provision, I think that changes a little bit. Again, there are no silver bullets, unfortunately, in this, but I think they would revisit how they deal with farmers and processors a lot better.

I think our focus on competition law might be overstated as well. Corporate social responsibility is another key issue here. Woolies and Coles ordain on farmers and look into their employment contracts through their Fair Farms initiative, for example, to say that we are going to come and look at your business as to how you are making contracts with other people. Woolies do not pay the same sort of respect to farmers to say, we will do the same with processors. So let us look at what the processors are doing with the farmers and ensure that they are dealing fairly with their farmers as well, which is an area that could be explored and in fact we have raised this with the supermarkets as well. Extend that corporate social responsibility to their supply chains including a fair dealings provision. That is something Coles and Woolies can do independently without government, with the help of government, either way.

The Hon. MARK PEARSON: Mr Thompson, you were talking about what you did personally, but I think it might be a good example. You packed up from the coast and moved to Cowra and invested in a dairy there, at a time when the dairy industry's future was in question as being a viable economy for anybody who was investing. Is that a risk that other dairy farmers are taking? How did you assess that risk?

Mr THOMPSON: Everyone saw deregulation in a different way. I saw it as an opportunity. Under regulation we had a quota system but those quota systems tied up a lot of capital on dairy farms. Under deregulation we had our compensation package. Some farmers chose to take that compensation and exit the industry with dignity. I still saw potential in the dairy industry, and particularly inland New South Wales. And so I chose to relocate to Cowra in the central west and start a new facility, start a completely different style of dairy farming to the traditional pasture-based farming, a free stall dairy.

Since that time, probably during that time, some of the issues that I came up against were, it took seven years to get approval. There were three court cases in the Land and Environment Court. It really highlighted the lack of planning in New South Wales for dairy farms inland. Since that time, we have developed a completely new system. We regularly have other farmers visiting our system. I had to go offshore. I had to go to the United States to get expertise to learn how to develop this new system. It is a system that has great potential to grow and make our New South Wales industry more sustainable.

The Hon. MARK PEARSON: Is it an intensive system?

Mr THOMPSON: It is an intensive system, absolutely. Yes, there was a risk. I do remember going to four banks to get finance. Three of them said no, and one said, "Yes, I will give it a go." So I went. Still there.

The Hon. SCOT MacDONALD: One of your recommendations is about business management and skills. I will give context; the Committee was in Moss Vale on Monday and heard from a lot of good dairy farmers. At the time it struck me that there was a lot of emotion in the room and there were also people making rational decisions. Is there too much emotion in this in some ways? We heard from people saying they had been there for three or four generations. Have we got enough skills to make those really difficult decisions, as you obviously are doing?

Mr THOMPSON: I really think there is an opening to improve the skill base in New South Wales farming, and that is something that the Department of Primary Industries and Dairy Australia and Dairy NSW are working on. And yes, there is a lot of emotion in the industry. Farmers that have been farming the same land for generations just struggle to comprehend with what is happening today and the way that their product has been devalued. That is causing a lot of angst, it is causing a lot of stress and emotion, and you are seeing that emotion come out. While it may not present that well, there is definitely a story behind it.

Mr SALARDINI: Just a quick point on rationality and emotion; I dare say if you take the emotion out of dairy farming, we will have a milk supply shortage, because it is that emotion that keeps farmers farming, despite the fact that it is not profitable. We can argue that is a bad thing but if you take an economic view, oh well, when the demand is low, supply should come offline, and when demand goes high, supply will follow. It does not happen because there is something called land use planning. Once a dairy farm shuts up shop, it will not be a dairy farm again. Go look at the Hunter. It becomes senior management or executive farmland retreats for the mining industry. Or on the North Coast, getaway houses for millionaires, basically.

This notion, make the rational choice and leave; well, the supply will not come back up when the demand goes back up, because we have land use planning and the purpose of that land will change, and it will not revert back as well. That is one issue that everyone should be aware of, the emotion is probably what is keeping milk in the fridge at the moment.

The Hon. WES FANG: I had a list of topics I wanted to talk about and we have already spoken a little about some of those. Mr Salardini, I had written down "lost leader". I can see by your response that triggered a very passionate response.

There was the decision in 2011 to market milk at $1 a litre potentially below the cost to the supermarket to bring people in. There is a margin on the milk. They like to say that it is not a loss leader and that they are generating a profit. If that is the case, they have obviously had to reduce their costs in other places, and that leads to a lower farmgate cost. What corporate responsibility do the retailers, and the processors for that matter, have as a result of reducing the price of milk by virtually half and then finding a way to reduce their cost base and to make a profit?

Mr SALARDINI: There is a lot in that question, but I will break it down one by one. First, we somehow think there is an objective answer to be had by the regulator. I will use the example of when the price went down to $1 in 2011. Does that suggest the supermarkets were gouging? If they could freely give back 60¢ to consumers and they did not, that would highlight a competition issue. We have had that for years. Prior to 2011, the price of milk was much higher. Why was no action taken? Obviously there was a breakdown in competition at that very point.

Secondly, if you can shift your cost to a less powerful actor, everyone will do it. I do not blame the supermarkets for doing that. We are asking whether that outcome is fair. Is it because of a power relationship or how markets operate? As Mr Thompson pointed out, we are seeing a decrease in the supply of milk—we have lost a couple of billion litres of supply and demand is flat. We are seeing that it is unprofitable and people are exiting the market. It was done through tight management of their costs without using the power they had to reduce the price. That is fair enough.

You then mentioned the issue of corporate social responsibility. That sits outside purely market forces and it is a key. One of the examples I would give is that people are concerned about animal welfare and the environment. It is very hard to be green if you are in the red. When you buy a litre of milk for $1, you squeeze the farmer's costs. It costs money for environmental stewardship; animal welfare measures cost money. Something has to give. This is the key juxtaposition. The supermarkets will say they are ethical and sustainable and that they worry about animal welfare and the environment. But how will those practices that you are pushing down the supply chain impact on the things you say are very important? That is the other point.

Finally, they meddle in the supply chain with regard to conduct. The example I would give is the Fair Farms Initiative. They say that your employment relationships should be of this nature, and we will come and audit them for other provisions. Are we ensuring that we have a sustainable dairy farming industry as well?

The Hon. WES FANG: So it is virtually transparency on the part of the supermarket and not the producers or even the processors?

Mr SALARDINI: That is right. There is one area of common interest. For example, through our engagement with supermarkets, we have noted that they have cost-adjustment payments for processors. The processors say they are finding it very hard and their prices have gone up, and the supermarkets will say, "Okay, cool. We don't want to push you to the wall. Here's a payment." Funnily, that price system does not filter down to dairy farmers. They say, "Our costs have also gone up. Why hasn't that been passed down to us?" Having some transparency and dialogue between the supermarket and the farmer might allow some of that cost adjustment to be shared down to the end. It seems that whenever there is an uptick, it stays between the processors and supermarket, but when there is a downturn it is shared evenly down the supply chain.

The final point on the competition issue we would like to make is that if the outcome of all these laws is for everything to become bigger, it seems there is less competition as a result and supermarkets are concentrated. Because of that, processors have become concentrated. In fact, in most geographies, we now have monopoly processing accessibility and farmers must consolidate. It is a strange outcome for a measure that was meant to create more competition given there are now fewer players in every market. I am not saying that dairy is special; it is across the board. It seems as though it should be called a "large corporations policy". The inevitable end game of competition law seems to be that everyone must get bigger. I do not know whether that is right or wrong; it is a casual observation.

The Hon. WES FANG: The conclusion of the New South Wales Government submission states:

> As farm gate milk prices are largely determined by international factors—

It then goes on to talk about New South Wales dairy farmers and the effect it has on their prices. I found that odd. You have already alluded to the fact that when you talk about the product we have in New South Wales that is processed into fresh milk, the international factors do not really apply to pricing. How is that fallacy allowed to continue? We have this glut—for want of a better term—of international milk and that is driving down drinking milk prices across the eastern seaboard.

Mr SALARDINI: As I said, there is some relationship, but it is not the predominant relationship. In certain geographies you could use that same southern pull and then add the freight cost and that would be the price of milk to a certain degree. But that certainly does not hold true for parts of Queensland and South Australia. If farmers were one entity, and it was a large entity, when people made that argument they could say, "Okay, we won't supply. Go through whatever chains you have and see how far you get." There would be no milk on the shelf. The difference is that farmers—

The Hon. WES FANG: They are fully loaded with debt.

Mr SALARDINI: Yes, they are stuck. It is a perishable good and they must milk every day. If they do not get rid it, it goes off that day. They cannot bargain, and when you cannot bargain people take advantage of you. If I go to a dairy farmer and say that I have changed my mind, what will they do with all that milk? That is the fundamental difference. There is a power imbalance and everyone knows it. It is whether we think that is fair or within the principles we have all agreed to.

The Hon. WES FANG: Do you think that power imbalance has a greater effect on the farmgate price than international prices?

Mr SALARDINI: Very much so. The supermarkets are the price setters. Let us not pretend there is this international market that sets everything. There was no change in the international price for milk when the price went from $1.60 to $1 a litre. Coles made that decision and Woolworths followed. This beautiful link between the international milk price and the price that mum and dad pay for milk in a supermarket is flawed because we should look at how the price was set in the first place.

The Hon. WES FANG: It is my interpretation that the international price does not play a large part in what we pay for drinking milk in this State and across the eastern seaboard, and the Committee has had testimony confirming that. Mr Thompson, you are running a dairy. Do you provide any drinking milk to major retailers through your processors?

Mr THOMPSON: We supply lime to process milk for the processors for processor-branded milk.

The Hon. WES FANG: Some of the major retailers have put a drought levy on their milk. Have you received any of that drought levy?

Mr THOMPSON: Interestingly, we received our first payment yesterday. I think it was 5¢ a litre.

The Hon. WES FANG: How much do you think the drought conditions have raised your costs per litre?

Mr THOMPSON: That is difficult to answer. For example, on my farm traditionally if we just take our feed costs, our ration would cost $6 per cow per day. We are currently feeding rations that now cost $8.50 per kilo per day. That is just an additional cost. We are certainly not a typical dairy farm. We produce all our of own fodder and some of our own concentrates. When it comes to increasing feed costs, we would be on the lower end of the scale but that is an increase of more than 25 per cent on our farm.

The Hon. WES FANG: You have allowed $6, you are at $8.50, that is $2.50. How much milk does your average cow produce per day?

Mr THOMPSON: We are producing around 43 litres per lactating cow per day.

The Hon. WES FANG: At $2.50, you are getting a bit less than $1.25 and your costs have increased. The drought levy Has not even covered half of your costs. Is it more of a marketing ploy than a genuine attempt to help farmers?

Mr THOMPSON: Absolutely. The supermarkets were very quick to jump on top of that. Obviously, farmers appreciate any help that comes their way in this crisis but there is a gaping wound that they put a little bandaid on and it is going to be ripped off again in February.

The Hon. WES FANG: We have spoken to people about possibly raising the minimum price of milk to $1.50 a litre in supermarkets. I note from the NSW Farmers Association submission that even with a branded milk price of $1.50 litre farmers are receiving the same price per litre if they are from the private label milk because of the contract with processors. Would we have to implement a way of ensuring that the increase in price is distributed evenly across the supply chain? Would that make sense?

Mr THOMPSON: I think that will happen. The Australian Competition and Consumer Commission made a claim that if the price went up in the supermarkets that would not necessarily flow through to farmers. That was a claim it made; there was really nothing to substantiate that claim on. I think it is back to supply and demand and I am quite confident that there is a shortage of milk in New South Wales at the moment and if processors could pay more they certainly would.

The ACTING CHAIR: Before I go to the Hon. Rick Colless, I have a question on the drought levy. This may have been determined somewhere else. That 1½¢ or 2¢ that you are getting back, is it going to be treated as taxable income by the tax office?

Mr THOMPSON: I would assume so.

The ACTING CHAIR: So you will not even get the 1½¢ or 2¢; you will get less than that.

The Hon. SCOT MacDONALD: If they pay tax.

The ACTING CHAIR: If you pay tax.

Mr THOMPSON: There are not too many farmers who do that.

Mr SALARDINI: I also have a quick point on the drought levy. The fact that you have to have this special provision during a drought suggests that the market is not working because farmers should be resilient during the time of drought to continue under the same forces as they were during the good times. The fact that as soon as the weather changes and the farmers are hitting the wall is indicative of a problem in the supply chain. I think that is the issue. The fact that you need a drought levy in itself—even if it was effective—suggests that there is something fundamentally wrong in the market.

The Hon. RICK COLLESS: I follow up on the drought levy. Mr Thompson, you said you were getting 2½¢. What is your understanding about what is happening to the other 7½¢?

Mr THOMPSON: The levy is actually only on whole milk. A lot of our milk goes into other products that do not attract the levy of 10 cents. There is a committee that determines where the money goes and how it is distributed. They basically have a pool of money and they have dairy farmers. It is spread across those farmers.

The Hon. RICK COLLESS: Can I perhaps explore your situation on your dairy farm? What is your average farmgate price that you are receiving currently?

Mr THOMPSON: Currently, the price this year is 52¢ per litre.

The Hon. RICK COLLESS: Can you give us some indication of what your cost of production is on a per litre basis?

Mr THOMPSON: Yes. Cost of production varies and depends on what you include in costs of production.

The Hon. RICK COLLESS: I might explore that without that current increase in costs due to the drought. We want to get to the root of this issue rather than how it has been distorted currently by the drought.

The ACTING CHAIR: Or exacerbated.

Mr THOMPSON: We would consider our cost of production—i.e. feed costs, power, fuel, labour, all those kinds of costs—outside financing costs. If we made a profit of 3¢ or 4¢ per litre in the past three or four years we would think we were going pretty good.

The Hon. RICK COLLESS: That would mean that if you thought that your cost of production was, say, 46¢ of 47¢ or somewhere around there you would consider you would be doing well.

Mr THOMPSON: Yes.

The Hon. RICK COLLESS: Would that include a full appreciation or assessment of your individual labour costs to your family? We took evidence the other day of a lot of farmers who were not drawing a wage at all out of their business. I do not want to go too deeply into your personal situation, but would that 47¢ include a full appreciation of what your family's labour is worth?

Mr THOMPSON: Probably not.

The Hon. RICK COLLESS: Mr Salardini, you mentioned the issue about price gouging and if they were making 60¢ a litre then that could be viewed as price gouging. What do you see is a fair and reasonable margin that retailers should be putting on their milk?

Mr SALARDINI: I am not here to say what that reasonable price should be. What I am contesting is some of the ACCC findings as to behaviour. If there is a claim that $1-a-litre milk is, in fact, well within keeping of no-one selling below a loss, the flip side of that claim is then the day before that happened Coles was making 60¢ of pure profit on top of whatever profit because they are saying $1-a-litre milk is also profitable. That is more than a super profit; that is a stupendous profit. If that is the case, there are serious competition issues within our supermarket sector. Go to the Grattan Institute report. It is not on milk, it is on the supermarkets. Essentially, they even break down the type of profit supermarkets are earning in Australia and it is one of the highest in the world. This is a key issue. You look at that and you look at the compliance and the actions against the supermarkets and it is pretty threadbare.

I have noted in every forum in which we are talking that the ACCC report's continuing highlight is absolving the supermarkets. But again I would say, "If that is the case, where is the competition and where are the benefits from that competition?" because we are the most concentrated supermarket sector in the world. They have super profits. Again smarter people than I have analysed that. Look at the Grattan Institute report. What happened before these changes? If $1-a-litre is profitable, where was the competition that did not drive that immediately when people were charging $1.60. That is the only point I would like to make. It could be $1.60 or it could be $1. I am not here to set the price but—

The Hon. RICK COLLESS: But I guess it depends on what price they buy it for from the processors and what price they sell it for?

Mr SALARDINI: Sure. If you take that point of view, then it does impact the farmgate price. You cannot have it both ways. If they have done it through pushing costs down across the supply chain, which is not necessarily a bad outcome, then you cannot have it both ways and say, "No, it has not impacted the price of farmgate and at the same time it is profitable and at the same time, prior to that, there were not gouging". It is a very interesting set of circumstances that absolve the supermarkets on every front. There is a bit of cognitive dissonance at play there because those three things cannot hold all at once; something has got to give.

The Hon. RICK COLLESS: You would be aware of the statement that Roger Corbett made a few years ago where he claimed that Woolworths had taken $500 million for the year off the farm sector and put it in Woolworths' profit sector. That is what you are talking about, I guess, that sort of—

Mr SALARDINI: I will not to put a number to it but—

The Hon. RICK COLLESS: They were his words.

Mr SALARDINI: They have flicked a few million dollars to the consumer. And, by the way, we understand competition, or that ticks the box. If we like that we like that, if we do not, let us do something about it.

The Hon. RICK COLLESS: The ACCC claims that the international price determines milk price in Australia. What is your understanding of what the average retail price is in other jurisdictions when compared to Australia?

Mr SALARDINI: I have not actually looked into that. I will take that question on notice and I can come back to you on that.

The Hon. RICK COLLESS: The other question I had related to the issue of power imbalance that you mentioned. The question is, is it fair or not fair? Obviously, if it is not fair, is there some way that we should be regulating that minimum retail price? If we do, what is your view on how it should be done?

Mr SALARDINI: I cannot believe I am saying this, but I guess the first port of call is self-regulation—put the pressure on Woolworths and Coles to see how they would implement fairness. When there is a will they are very good at getting an outcome in the market. Look at what they have done in terms of free-range eggs and caged eggs and some of the other animal welfare provisions around stall-free sows. They have managed to put something in place that has changed the whole supply chain to the point where egg producers will now have to change the whole fit-out of their sheds to meet what Coles and Woolworths have ordained.

So when there is a will with Coles and Woolworths, there is a way. I would not firstly pull the regulation trigger. Let us put the onus on them—give them some time and say, "You come up with what you think is fair and let's see if that works." If not, we will have to sit down and figure out what can be done. One of the issues is in having a fairness provision. Let us look at the European Union and look at what the fairness provision in the competition law might give people in the supply chain when they are dealing with unequal power. That might be one solution which might sit a little bit outside of a State level. But from a State Government level, that farmer advocate process would be very useful because it would change the Coles and Woolworths behaviour.

There is a court case to be had, which will cost millions of dollars, which is not their concern, but the reputational damage that they would suffer from a court case on issues in the supply chain of unequal power and market abuse, would quickly change their behaviour. You would see that the prices they pay their supply chains would quickly change as well.

The Hon. JOHN GRAHAM: I just want to chip in quickly. I invite the association to provide some additional material to supplement the strong view you have put in front of us today. The views you have put to us today are useful but they are just not borne out in the submission from the Farmers Association. If you want to put that strong view about the ACCC findings, using their compulsory information gathering processes, you need to supplement the view you are putting to us in writing. I think that the Committee is open to it. There are some serious issues here. What you put in front of us in writing does not give us enough information to be able to put the view, so I invite you to—

Mr SALARDINI: We will provide you with our submission to the ACCC—our dairy review—which would, more or less, cover that.

The Hon. WES FANG: That would be ideal.

The ACTING CHAIR: Thank you very much for your time here today and for your submission. I am looking forward to the supplementary submission. I think you took one other question on notice. The Committee has resolved that responses to questions on notice should be provided within seven days. The secretariat will get in touch with you about that.

(The witnesses withdrew)

(Short adjournment)

MICHAEL JEFFERY, Deputy Chairman, Norco Co-operative Limited, sworn and examined

GREG McNAMARA, Acting Chief Executive Officer and Chairman, Norco Co-operative Limited, affirmed and examined

The ACTING CHAIR: I welcome our next witnesses from Norco on the North Coast. Would either of you like to make a brief opening statement?

Mr McNAMARA: I would, with caution. We come with reluctance today. As you would be aware, we asked our closing paragraph to be in confidence. That was driven by a strong relationship with a number of retailers. We are very conscious of anything we say and how that can be misconstrued or could have a long-term effect on our contractual relationships, which would have an ongoing relationship, with our members, through pricing and our profitability. We are cautious.

The ACTING CHAIR: Rest assured that none of the Committee members would have breached that confidence. You should feel free, if any of the questioning starts taking you down that path and you feel uncomfortable, to say so. If you want to, there is an opportunity to take evidence in camera, which means that those present would be just Committee members and yourselves. But my knowledge of where we are going with this leads me to suggest that all Committee members will be quite sensitive to your concerns, and you acknowledge that.

Mr McNAMARA: I suppose I would be guided by the Committee. I think the reality is that with the relationship with the retailer or retailers and the ACCC report, there is conflict.

The ACTING CHAIR: Yes.

Mr McNAMARA: I am not sure how to actually handle that without putting Norco at risk.

The ACTING CHAIR: Okay. We will be quite cognisant of that.

The Hon. RICK COLLESS: Chairman, if I could make a comment: I think the important thing is that if you are faced with a question from one of the Committee that you think might be putting your confidentiality at risk with your suppliers and retailers, but it is something that perhaps the Committee may benefit from knowing, at that stage you could say, "We decline to answer that but we are happy to answer it in camera." At the end of your time, we will go briefly into the in camera stage where other people in the room will be removed.

The ACTING CHAIR: And we can just deal with that.

The Hon. RICK COLLESS: At that stage, the evidence you give us will remain confidential and will not be included in the transcript.

Mr McNAMARA: Now we have got through that, I will make some overarching statements. The critical point for us in the industry and for Norco is that we think it is a critical point. We have seen production in the Australian dairy industry move from more than 11 billion litres back to a projection now by Dairy Australia that it has come back to around 8.6 billion litres, which is significant and almost back to the level of 20 years ago. We think that to arrest that situation, significant change needs to happen. One of the challenges of the industry is that it is just not seasonal conditions: It is the incremental increases in costs that continue to occur that cannot be passed on or are reflected in pricing arrangements.

We are reflective of what is very much a global market, that products come and go, and how that actually works. But the Australian industry is a very different industry to the New Zealand industry or the European industry. One of our most recent views on the sector where the retailers moved to a situation was moving to funding drought aids by putting on products, like a three-litre bottle, 10¢ a litre or raising prices on a short-term basis. In my view, it is not actually a position that the industry wants to move to where we move to a welfare mentality. As many of you would be aware, there is a part of society that has moved to generational welfare pieces. What we are finding is that the younger generation, good farmers, do not want to go down that welfare path and do not want to be looking for handouts on a regular basis. They want a viable industry and they want to have an industry that they believe is going in a direction.

The current debacle of the lack of incremental increases in price and the incremental increases in on-farm costs coupled with the drought has reduced the resilience of the sector dramatically. Twenty years ago people would have increased production and added cow numbers to try to drive through it, but it is the reverse now. If you are struggling as a farmer the first thing you should do is reduce your costs. If you are losing money on every litre of milk you produce, you should reduce your herd to reduce your cost. We encourage people to do that. If you look at the numbers that is reflected in the industry. The industry cycle has changed from the nineties where you tried to drive yourself through your production to increase your cost to get those recoveries back into your business and improve profit. It does not work that way anymore. It is the same in the factories. What happens on the farm and what happens in the factory situation is of a similar nature.

The industry has a significant problem. I do not believe there is one fix but I think that Mr Salardini from the NSW Farmers Association made a very good point. If there is a desire by participants in the dairy industry—and I include the retailers in that—to arrest the current situation, then we can change. But we have to have that will of all stakeholders to do that. The Federal Government, through David Littleproud's office, has moved to a mandatory code or is bringing in a mandatory code and reviewing that. That is not a bad thing. It is a start, but it will not solve the issues. It will help as one of the catalysts to moving us. But the next stage is whether it is the effects test or a program in which the farming sector—and I do not just say dairy, but the farming sector—has an ability to negotiate pricing arrangements in circumstances to ensure supply and viability.

It gets back to that point of: How does the Government's help us to bring the retailers to the table to have a truly reflective conversation around what the costs changing on farm are and how we, as an organisation or a processor, help pass the benefits that we can negotiate through retailers back to the farm sector.

The ACTING CHAIR: We will begin questions with The Nationals. You guys can fight among yourselves to decide who will begin.

The Hon. RICK COLLESS: Thank you, Chair.

The Hon. WES FANG: We do not fight—not really seriously.

The ACTING CHAIR: Oh—I read the media this week.

The Hon. RICK COLLESS: But while you were reading our media, you were not reading yours.

The Hon. JOHN GRAHAM: That is why he was reading it.

The Hon. RICK COLLESS: Sorry, gentlemen. You operate as a cooperative in the true sense of the word, do you not?

Mr McNAMARA: Yes.

Mr JEFFERY: Yes.

The Hon. RICK COLLESS: Can you tell us from your cooperative's perspective the cost of processing milk from the time you get the raw milk from the farmer until you deliver it to your retail sector?

Mr McNAMARA: I think the best way to answer that is to give approximate numbers.

The Hon. RICK COLLESS: Yes. I am happy to take approximate numbers.

Mr McNAMARA: You are looking at around the 92¢ to 93¢ cost by the time you collect the milk from the farm and put it in a bottle to get it ready.

The Hon. RICK COLLESS: And deliver it to the retailers.

Mr McNAMARA: Yes. It is somewhere around that 90¢ per litre mark. Depending on the fact that you have to think about distances. You need to segregate the market. The retail sector will have semitrailer heading to their warehouses and it heads into their chilled routes. For the route trade, or what we call the cafe market or the smaller retailers, it goes in a smaller truck and may go a lot further. We may be carrying that cost. It just depends on the cost structure and the end delivery point.

The Hon. RICK COLLESS: It is fair to say though that it is somewhere around 90¢ a litre?

Mr McNAMARA: Yes, in excess of 90¢ a litre. I should specify that that is in Queensland. It will change depending on the input prices too.

The ACTING CHAIR: Because you do supply both Queensland and New South Wales?

Mr McNAMARA: Yes.

The Hon. RICK COLLESS: Does the cooperative make a profit in its own right?

Mr McNAMARA: Yes.

The Hon. RICK COLLESS: How are the profits distributed?

Mr McNAMARA: In three ways: through milk price, dividends and some rebates.

The Hon. RICK COLLESS: Back to the members of the cooperative?

Mr McNAMARA: Yes.

The Hon. RICK COLLESS: You also mentioned that there are big differences between the New Zealand industry, the Australian industry and the European industry. What are the key points of difference?

Mr McNAMARA: One of the pieces that gets lost in Australia is the geographical distances covered in Australia and the cost they bring to the Australian dairy industry, which is quite significant. And it is not just about the logistics; it is also about the fact that there are not the same pools of farmers close together. New Zealand is a small country and there are thousands of farmers in a relatively small space. Communication and education have a different function to what occurs in Australia and they way we go about it. The second piece is with Europe. I do not think it is ever taken into account when having the conversation about the removal of subsidies a number of years ago that they were replaced with environmental subsidies.

The Australian industry and the retail sector do not talk about the fact that there are two income streams in the European model that support the farming sector—one about what they get paid for the milk and one about the environmental stewardship that they bring to the farming and agriculture sector. I am not exactly sure on how that works on a country-by-country basis in Europe, but I am aware that it is makes up a fairly significant percentage of farmers' incomes. In Australian it is somewhere between 1 and 2 per cent. With profit streams, that can mean the difference between making money and not making money.

The Hon. RICK COLLESS: The other day, we heard evidence that suggested that the New Zealand retail price was around $2 a litre, which would be about $1.85 in Australia. Have you got any figures as to what the average price in Europe is?

Mr McNAMARA: No, I could not tell you.

The Hon. RICK COLLESS: Do you think that the $1 per litre retail price in Australia is appropriate, given that you have just suggested that you would be supplying your retailers at around 90¢ per litre? There is not a big margin left for them, is there?

Mr McNAMARA: No.

The Hon. RICK COLLESS: What do you think needs to happen in the industry to get over the hurdles that we are facing at the moment?

Mr McNAMARA: I think the dollar a litre is the base catalyst of pricing. It is really interesting to look at the dynamics of what the retailers put on around the changing of volumes in the milk industry. They had a three-litre milk bottle for $3 and a drought-relief bottle for $3.30. Our experience was that when that was introduced there was a significant movement away from the three-litre bottle back to a two-litre bottle. That told us that many consumers, for one reason or another, are actually choosing to buy milk on price. From a consumer's perspective, if there is that choice then they accept that. But what that choice is not reflecting is the sustainability of the industry and investment we need to make in the industry on an ongoing basis. It is 90¢ now and the minimum wage in Australia has gone up 3.5 per cent this year. Every farmer who is employing labour will add that to their expense side.

Then they have to couple that with, on the eastern seaboard, significant fuel cost increases and significant electricity cost increase. And we are not talking about prices jumping 10 or 20 per cent; we are talking about, in some areas, them jumping 30 or 40 per cent. There have been significant increases in rates—rates went up 7 per cent and they are incremental. When we throw on top of that the fact that the cost of grain doubled—it went from $250 a tonne to close to $550 a tonne—the ability for the sector to absorb the costs is beyond its capacity. What we are now seeing is that farmers have spent all their money and have filled their credit cards up and are now withdrawing their maintenance programs and have cut their labour. They are exhausted. The resilience of the sector has diminished and we are now seeing farmers leave the industry for that reason.

The Hon. RICK COLLESS: As a cooperative, how are you managing that, knowing that the farmers do not have any more room to move and have not been getting the consumer price index [CPI] increases? How do you manage that as a cooperative?

Mr McNAMARA: We went to the retailers in late July. We knew that the white grain harvest in Australia had been missed. There was no rain and we could see that the grain prices were moving dramatically. We put the scenarios together of what the cost increases would be. We took a scenario to the retailers of increasing the price by 10¢ a litre to support our farmers for a period of time. That got knocked out. We went back with another proposal to support them with 5¢ per litre for the months of September and October. Then we moved from a proposal to, "We are doing this." It was to test the theory from the ACCC. The ACCC report clearly said that we could as a processor put forward a price increase to the retailers and that they would have to accept it.

The Hon. RICK COLLESS: And they did?

Mr McNAMARA: After we implemented it. I would suggest that that is a fundamental flaw in the ACCC report. There was a lack of reflection within the ACCC report on how a price increase would occur on the shelf it the retail sector. It does not ring true for me, knowing how it works and how we would negotiate it. The reality is when we negotiate it, the sales team take a proposal to the sales team of Coles or the retailer and they have a conversation around what that looks like and then they have a conversation about how much shelf space is included and the promotional activity and range of activities that go around it. But we do not effectively set the retail shelf price; the retailers do.

To actually change the price on the shelf—if we are going to put a price increase that flows through—they need to agree on a whole number of things along the way. I do not just pick up the phone and say, "Hey, Mr Durkin, I now have a price increase." It does not work like that. The reflection that the ACCC completely missed is that the relationships we have in the retail sector are very important and we negotiate our way through that, versus just passing a direct price increase through.

The Hon. RICK COLLESS: Do you supply all the major retailers?

Mr McNAMARA: We supply Coles in generics and branded product and we supply Woolworths in branded product—when I say "branded" it is the Norco brand. We were suppling Aldi but we have ceased suppling Aldi. Due to the nature of our relationship with Aldi, the contract was not of value to us so we chose to exit that arrangement.

The Hon. RICK COLLESS: I think you said before that you also supply some of the smaller retailers?

Mr McNAMARA: Yes. Coles would make up 37 per cent of our business, if we add the branded and private label to it. The rest of it is made up of our route trade. We have more than 80 distributors from Cannes through to Sydney distributing product for us.

The Hon. RICK COLLESS: The major retailers are the $1 a litre proponents. What is the opportunity for the negotiation that Mr Salardini was talking about? How do we get them to see that they need to lift the price to allow some of that money to flow through back to the producers?

Mr McNAMARA: I do not think this is the answer but part of it is actually understanding what has just happened in the drought. There is a sector of the community that is very price-sensitive. If the route trade moves dramatically in price, then consumers continue to shift to the retail sector. So what you are seeing incrementally over time is that they will end up with a larger share of the market due to their pricing strategies of a dollar a litre. This is the gain, I believe, the piece that the ACCC misunderstood or misinterpreted. There is a base misunderstanding that a dollar a litre set for market floor price—the bigger that differential becomes between a route trade—

The Hon. RICK COLLESS: When you say it sets the market floor price, you are referring to the retail price, are you?

Mr McNAMARA: Yes. So a dollar a litre basically sets that floor price in the market and the more the price differential moves in the branded or the route trade, the more people slowly move back to that private label generic stock product.

The Hon. WES FANG: They are fascinating insights. Thank you very much for coming today. You said that 37 per cent or 38 per cent of your product goes to Coles and that is both the generic and Norco-branded milk?

Mr McNAMARA: Yes.

The Hon. WES FANG: If it is commercial in confidence I understand, but would you have it as private label production from Norco? I know you had Aldi before. Is it a 80:20 split or 10:90?

Mr McNAMARA: With Coles?

The Hon. WES FANG: In general, with whatever private label you may produce. I know you have dropped Aldi now. What percentage would you have done private label versus your Norco-branded milk?

Mr McNAMARA: Before October we were doing probably close to 30 per cent of private label but now it has probably dropped back under 30 per cent. We could probably get you those statistics, if you were looking for them.

The Hon. WES FANG: If you could take that on notice, that would be wonderful. The reason I am asking is that you said before that we have gone from 11 billion to 8.6 billion litres as a market. We have seen the milk volume drop out. I am assuming that 11 billion was when we had a retail price of around $1.60 or $1.70 a litre so milk has gotten cheaper by implementing this dollar a litre milk; our volumes have gone down. We did not really have a glut of milk before at 11 billion litres so the demand for the product is still there. Does that dollar a litre milk devalue the other part of your business that you sell at Norco because it is in the marketplace?

Mr McNAMARA: Can I answer that from two perspectives?

The Hon. WES FANG: Yes?

Mr McNAMARA: If you are a farmer I would say, yes, you are right, it devalues the marketplace but if you are a processor—the key relationship you have with the processor is when you are negotiating a private label contract, you would negotiate the private label contract—and the branded piece is a completely separate conversation—and you do it on whatever term is appropriate for you and you sign that off and it is a contract. Then you will actually do a separate negotiation, which will be months apart, on your branded product and your access to the shelf and there will be a different set of arrangements. Private label will very much be delivered price into the warehouse whereas branded products are much more about your marketing programs, your innovation and a whole range of things that occur around that.

The Hon. WES FANG: I noted you suggested a drought levy to the retailers. Was that on both the private label and the Norco-branded milk?

Mr McNAMARA: No, we just went straight with our base price increase to our farmers. We wanted every farmer to get exactly the same price for that milk. We wanted to be really simplistic in that: How do you explain this to the market; not complex. So we sent a note to Coles to say that we would be raising the milk price 5¢ a litre from 1 September and that would continue until the end of October with a review after that. After lunch today we will announce that we have actually continued it through for November and Coles have quite willingly come on board to actually pay their part of their 5¢ a litre.

The Hon. RICK COLLESS: So that is coming out of their $1 a litre?

Mr McNAMARA: Correct, but we are paying it across four litres. They are only just paying it on the bit that they get.

The Hon. WES FANG: Originally you suggest 10¢ a litre and that was not accepted?

Mr McNAMARA: Kicked out the door, yes.

The Hon. WES FANG: Now we have seen some of those retailers implement on their larger generic private label branded milk a drought levy?

Mr McNAMARA: Yes.

The Hon. WES FANG: Cynically I think that is possibly more of a marketing ploy than a genuine attempt to try to assist farmers through this drought. Are you seeing a return back through Norco to your farmers off that levy and if so how much per litre are they getting?

Mr McNAMARA: We have only got the Coles piece. Coles have actually put it on their product and they have made sure that that will go into their Coles drought levy fund and our farmers, just like all other farmers, have to apply to actually get access to it. We have no idea how much will be in that fund and that will not actually occur until the announcement on who has actually received moneys from that, what farmers have got it and how much; that will not actually happen until sometime in January. The disappointment from our perspective as a cooperative is that there was a poorly handled scenario within the dairy sector around what is the best outcome that we could actually look for to help the dairy sector going forward.

A drought levy is nice in one sense but, as we all know and as Dorothea Mackellar said, Australia is a place of droughts and flooding rains, so you will go from one extreme to the other. So our proposition has always been that we should actually be looking for an incremental price increase on farm to support the farming sector. Drought may be part of it and from time to time that will move. I think the issue the industry faces is a lack of good leadership around what is needed for the industry to move forward and to provide people like yourselves good understanding of what the industry actually needs. One of the downsides of the deregulation of the industry is there has been a lack of good leadership coming forward to harmonise the industry and to actually work with government and the sector.

The Hon. SCOT MacDONALD: We had discussion with the DPI earlier and one of their main planks was that they still felt there was an imbalance and a production oversupply. Is that your view and is that righting itself?

Mr McNAMARA: Sorry, can you say the question again?

The Hon. SCOT MacDONALD: The DPI is asserting a structural issue in the industry is that there is oversupply of white milk, which is having some impact on holding the price back.

Mr McNAMARA: No. In northern New South Wales and Queensland there is an undersupply; we are actually bringing milk in. I think that is a misunderstanding. How the industry has worked in the past is that the fresh milk industry has always been the most reliable and stable price setter for milk in the Australian dairy market for a very long period of time. The regulated industry actually supported that so if there was a drought or difficult circumstances, affected lobby groups would go to the Government and look for an effective price increase to actually support farmers through that. Every year there would be a consumer price increase.

Over time, the dairy sector actually developed a very strong fresh milk industry. That helped the industry to build an industry that actually added value to things like cheese, yoghurts, ice creams and a whole range of other things. Parts of Australia now have different pricing models depending on the processor used. A processor like Norco has predominately fresh milk. We have an ice cream business and we have components for that but predominantly we are a fresh milk supplier and we are reliant on that. Yet you will go to other sectors within the industry in the lower parts of Australia, in Victoria and lower New South Wales. They might have a cheese plant, or a milk powder plant that is a predominant, and they have a different cost structure around how that actually works.

The Hon. SCOT MacDONALD: You do not see an imbalance in supply and demand, either regionally or even broader, say east cost?

Mr McNAMARA: No, not at all.

The ACTING CHAIR: Norco is predominantly milk and ice cream?

Mr McNAMARA: Correct, yes.

The ACTING CHAIR: You do butter as well?

Mr McNAMARA: No, we do not. We sell a butter brand but it is actually made by us under licence by a cheese branch.

The ACTING CHAIR: Regarding the transportation of milk from your dairy farmers to your processing plants, does Norco have a trucking fleet, or do you subcontract that out?

Mr McNAMARA: Subcontract it out, but very much under our control. So relationships with companies like BLU Logistics.

The ACTING CHAIR: How many farmers are involved in Norco?

Mr McNAMARA: Around 220 farmers, 313 members.

The ACTING CHAIR: How far north and how far south do they go?

Mr McNAMARA: If you are thinking, the furthest south farmer would be at Dungog, and the furthest north would be Maleny, a bit further up, South Gympie.

The ACTING CHAIR: Are you seeing many new entrants into dairy farming? Are there many people coming into the dairy industry in the Norco area, or are you seeing a consolidation, an aggregation within the sector?

Mr McNAMARA: There have been no new ones that I am aware of in the past 12 months. Prior to that, go back three years ago when we had 13 new recruits, young farmers starting up, pretty much someone in their late twenties, early thirties, someone has helped them lease a farm and they started their farming operation. They have done really well. But the first thing, and this is one of the conversations we have with the retailers, when you get a downturn in the industry, the ones that are most at risk are usually the younger generation, they are more exposed.

Unless you are able to—and this is one of the reasons we talked about the 5¢ a litre price increase, we could see very early on this was the group that actually put themselves out there, they borrowed capital on the view that the industry was moving in the right direction and price increases are coming through. Then when the prices stabilise and the costs go up, they are the first ones that have significant pressure. They have young kids, they are saddled to the hilt with debt, and they do not see any way out other than to close the dairy production. We have seen two young farmers of that group leave the industry.

The ACTING CHAIR: If there were three things that the government of the day had to do in New South Wales to improve or ensure the sustainability of the dairy industry in this State what would they be?

Mr McNAMARA: I think one is to work with the Federal Government to bring policies that support the agriculture sector and dairy industry. In our case we should be interested in dairy, but building a national food plan and having a national food plan that supports the industry, not only from a security perspective but also from a perspective of ensuring that we have got an export industry and developing jobs. I think there is a national plan around that. The other one is around pieces like the mandatory code of conduct, and the Federal Government doing things on that I think is a good thing but it needs to also extend to, what can this Committee do is put pressure on the ACCC report and figure out whether some of those reports are really reflective of what they have actually seen and how they work. So, working on that.

I think the other one is to make sure that we have got an innovative society. If we want to encourage the dairy industry in Australia to be globally competitive and increase our milk volumes, then we need to be competitive globally. That means we need to have innovation programs, whether it is in processing, whether it is on farm, and that is an investment that I would suggest that the Government needs to think about having a program. It is part of building that national food plan. How do we invest in the agriculture sector to ensure that in 20, 30 years time we have a dairy industry that is not only able to supply the Australian consumer with products, but actually also have a global presence that is globally competitive?

The Hon. JOHN GRAHAM: I wanted to test some of the findings of the ACCC, particularly about the farmer-processor relationship with you. I am conscious that your relationship is different to much of the rest of the industry, so I am interested in your views about the industry generally. The ACCC found the key power imbalance is in the farmer-processor relationship. Do you believe that is a fair finding when you look across the industry? That is where they put their emphasis.

Mr McNAMARA: It is interesting, is it not? If we could pay an extra 5¢ a litre for the milk on an ongoing basis and we could negotiate that with the retailers, then we would do it. From our perspective, why would we not negotiate a better price to support our farm sector and still maintain profitability? I think the piece that the ACCC has missed is the change in the environment in the Australian dairy industry in the last 20 years. Twenty years ago there was a Bonlac cooperative, there was a Bega cooperative, there was the Warrnambool cheese and butter cooperative, there was a Dairy Farmers cooperative, and there was Norco, and a few others. We are it.

The rest of it is pretty much—other than Bega moving to a listed entity, the industry has moved away from that. We are building an Australian dairy industry. We are here to look after our shareholders, wherever they are. The challenge I see the industry has got is how do you bring an international competitor into the marketplace to build an industry and to support that industry and its growth.

The Hon. JOHN GRAHAM: They have acknowledged that change up front. What they have said though is, even if there were 5¢ a litre coming back in through the processors—this might not be true of you but they are aiming this criticism elsewhere—farmers are not going to benefit because of the power relationship. It is true, is it not? That is not going to flow through to the farm gate in the current structure of the industry?

Mr McNAMARA: I agree with what you say in technical terms, but it is the opportunity for the coop sector and the farm sector to work closer together to have a stronger cooperative sector, because that is exactly what we do.

The Hon. JOHN GRAHAM: You are saying you are different, and I accept that case. That is one of your advantages. You are using that to your reputational advantage, but it is true of the sector as a whole, is it not?

Mr McNAMARA: The challenge in this is the mandatory code. Assume that the mandatory code comes in and one of those pieces is that a farmer can change. If you have got a pricing arrangement that is not competitive with your next best option, then at a point in time you can exit your arrangement under appropriate circumstances. The interesting part around the mandatory code is that, will it create enough competitive tension in the market to allow milk to move to actually push the price? Norco is such a small piece in the market, we can influence it in our market but we cannot influence it in the Victorian market.

The Hon. JOHN GRAHAM: Understood. On the specifics of Norco's business, following on from my colleague, what is the proportion of your business which is going to export at the moment?

Mr McNAMARA: It would be less than 1 per cent

The Hon. JOHN GRAHAM: That is largely the ice cream?

Mr McNAMARA: A little bit of milk.

The Hon. JOHN GRAHAM: A little bit of both, but it is not a big factor for you?

Mr McNAMARA: Yes.

The Hon. JOHN GRAHAM: Again on Norco's business, one of the reasons why the ACCC has landed where it has is because it says that, essentially almost all of the contracts for private labelled milk have passed through clauses, so whatever is coming through the farmgate price ends up being passed through to the retailer, and that is in the contract. That is what their finding is. Is that the case with Norco?

Mr McNAMARA: The way our milk price is set with Coles on an annual basis is that whatever number we finish at, at the end of the previous financial year, so thinking about 30 June Norco works out what it has paid its farmers over the course of that year on average. That average price becomes the price for the next financial year. What we have tested is if Norco wished to change that price and renegotiate that price after 30 June, due to circumstances such as drought, can we pass it through? And that is an interesting question.

The Hon. JOHN GRAHAM: But they are two slightly different questions. You are talking about paying through the nose or passing through over time.

Mr McNAMARA: I would suggest that technically the ACCC is right. The clauses in our contractual arrangements provide that the closing price on 30 June is the opening price on 1 July.

The Hon. JOHN GRAHAM: I refer to observations on information asymmetry. It sounds as though it is really in the processors' hands much more than the farmers' hands. That is, the knowledge of the pricing, the status of the market and where the changes are and the products. Do you think the observation is fair that that is, again, one of the sources of power here that is working to the disadvantage of individual farms and that that information is held much more tightly at your level? I again acknowledge that Norco is in a slightly different situation from much of the industry.

Mr McNAMARA: I would have thought the industry had good information through the Dairy Australia "Situation and Outlook" report. It is more relative to the timing of availability to information. The challenge for the farming sector is choosing the processes that suit their model or their farming system. In Queensland, you choose a model that supplies the fresh milk industry; you would not choose a cheese plant or a milk powder operation. However, a seasonal farmer in southern Victoria would choose a different model because of the different products. I am not sure farmers have a lack of information about their products. It will be the range of products a company supplies and their customers that should influence their decisions about who they supply.

The ACTING CHAIR: Mr McNamara, you know my views about cooperatives. The sector is moving away from them, but you are clearly doing well. Why have others moved away from the cooperative model?

Mr McNAMARA: There were significant failures, such as Bonlac. The Dairy Farmers Cooperative was successful, but people capitalised the value and took the money. The same happened to Warrnambool Cheese and Butter. The Bega Cheese situation was different. They had a growth strategy they wanted to embark upon, which is a good story. Some of it is simply about people not running businesses well. That is not necessarily to suggest a cooperative failing, but you need to run a cooperative on a very commercial basis. We have followed an evolutionary process of working with members and supporting them as best we can. But that cannot come at the expense of the company. One of our challenges is that we can pay only as much as we can afford to pay without putting the business at risk. If you think of the Murray Goulburn example, they were the issues; that is, they took a risk that did not pay long-term dividends.

The ACTING CHAIR: Has Norco looked at the Trans-Pacific Partnership in terms of potential opportunities and potential impacts on your business model?

Mr McNAMARA: Not in great depth, no.

The ACTING CHAIR: The Committee heard evidence this morning about the concept of a milk commissioner. The NSW Farmers Association today called for a farmers' advocate role, similar to a milk commissioner. Does Norco have a view about the need for that role in New South Wales? That is, do you believe there is a need for someone to advocate on behalf of the industry in disputes between dairy farmers and processors, or dairy farmers, processors and the retailers?

Mr McNAMARA: It is interesting, but I am not convinced about how it would work to provide benefits. It sounds nice, but I would need to understand the practicalities.

The ACTING CHAIR: The concept is—

Mr McNAMARA: The concept is nice, but I am not sure how it would work in practical terms.

Mr JEFFERY: From our position as a farmer-owned cooperative and governed by a board of farmers, we do not see it being as necessary as some other producer groups might who deal with other ownership models.

The Hon. MARK PEARSON: If you were to step back and view the dairy industry objectively, its viability and, as you said, the current lack of good leadership, and also climate change and Australia's environment, has Norco or the dairy industry ever considered moving away from animal-based milk towards plant-based milk using the same properties that are thriving, or not thriving in this case? Have you considered that it might be wise to move towards a plant-based milk industry—although I do not think we can use that term legally? The plant-based market is flourishing.

Mr McNAMARA: We sell plant-based milks. If a customer wants a plant-based product, we can provide it. We are not opposed to plant-based products, but the definitive answer is that we have not encouraged farmers to plant pecan or almond trees to offer those products.

The Hon. MARK PEARSON: We are hearing that the dairy industry is in crisis. Would that be wise advice? Obviously Norco has not turned its mind to that.

Mr McNAMARA: It is about a diversity of income streams that allows farmers to spot. The reality is that Norco would not survive under that model because not enough consumers have moved down that path. There is an increasing number of people who would prefer to drink a plant-based product, and that is fine. But it is not a big enough industry to support 200 farmers at this time. That evolutionary process may take 10 years to 15 years. Planting trees and harvesting the plant-based material may take a significant amount of time.

The Hon. WES FANG: Given the industry is in crisis, as the Hon. Mark Pearson said, and I tend to agree, in the short term would it be easier for milk to be priced fairly and for that price to be distributed evenly down the chain so that farmers get a fair farmgate price? Or would it be easier to disassemble and to plant trees and wait for 15 years to harvest?

Mr McNAMARA: I think the people who like latte would have an issue with that. It is interesting. The concept that it is all about fresh milk is misconstrued. You need to think about how the farm sector has aligned itself with different processors and different processors have different product ranges. I had a conversation with an ABC reporter about this. Not every processor has fresh milk. If you increased the price by 10¢ across Australia any everyone supplying fresh milk got a 10¢ price increase, what would happen to those supplying cheese, butter or ice cream? If you talk to those farmers, they are in a similar situation to the fresh milk industry. The whole dairy sector has maintained relatively stable pricing for some time. Until we can move the entire industry to support the sector and to get price increases, we are in trouble.

The Hon. WES FANG: While I agree with that, it seems predominantly that the biggest change in the dairy industry at the moment at the retail level has been that $1-a-litre milk. The other products—the butters, cheeses, ice creams—have all been relatively stable in price. They have not seen a near 50 per cent, a 60 per cent or a 70 per cent reduction in their retail price overnight. They may go on special, but that price drop has had a dramatic effect on the industry. We know the Woolworths model, where it has applied the drought levy on, I think, its two-litre and three-litre milks now, and now it is providing that back to the farmers. While it is a 10¢-per-litre levy on the milk, the farmers are seeing 1¢ or 2¢ per litre coming back because it is amortised over their total production.

Given that the $1-a-litre milk is pretty much the catalyst for the industry moving into the direction we have seen now, an increase in the base price or floor price of milk, while you may not see that 10¢ per litre coming back to the farmer directly because it is spread over the amortisation of the whole industry, it would increase the farmgate price. Would raising that dollar per litre and even setting it to the consumer price index—because, effectively, having not had an increase over seven years, it is a price cut—go some way to helping the industry?

Mr McNAMARA: Absolutely, because if you think about it, if the price raised 10¢ a litre on the retail shelf and the processors got a percentage of that, then every processor who is supplying fresh milk to the industry would be striving for picking up more supply to supply to additional customers, which creates a competitive tension. If you are supplying cheese or powder, then you have got to be able to compete in that market. They would have to be forced to go back to the retail sector and talk about "I am competing for price, then the whole market is starting to actually move in the right direction". It is almost that the consequential effect of changing one price has a long-term benefit to the rest of the industry.

The Hon. WES FANG: Do you know on average what your farmers are paying to produce a litre of milk and what is it that they are receiving at the moment? Are you able to tell us that?

Mr McNAMARA: Our average price for them at the moment is around 61¢ to 62¢ a litre.

The Hon. WES FANG: To the farm gate?

Mr McNAMARA: Yes. Their costs depend on where they are. If you are on the Darling Downs and you are on total mixed ration—TMR—and if you are definitely drought affected, it is probably higher than that. If you are on the coast, it is somewhat less than that. It just depends on what they are paying for grain and their grain mixes, but they would be breaking even. Norco runs a rural retailing division so we supply many of our farmers—93 per cent of our farmers—with their goods, for grain, fertiliser and chemicals and all those sorts of things. We have a very good visual over their ability to pay their bills and how their costs have increased on just the farm inputs. The extension of terms that we are actually seeing because people cannot afford to pay their bills is really putting pressure. We can visually see that and we know that they have clearly—as soon as people get into 60 days to 90 days to 120 days, they are not making money.

The Hon. WES FANG: Do you have an outlook for how long you think this may continue?

Mr McNAMARA: We believe that is due to the lack of harvest and the fact that grain is coming from the Western Australia end of the Brisbane port, and that will continue until there is a harvest of white grains next October.

The ACTING CHAIR: The Hon. John Graham had one final question but I will ask a question before that. As I said at the start of your testimony, is there anything you feel you have answered here today that you want to clarify or add to in Committee?

Mr McNAMARA: I am good.

The ACTING CHAIR: All good?

Mr McNAMARA: Yes.

The Hon. JOHN GRAHAM: I only wanted to give you the chance to respond to one of the final ACCC observations. Feel free to respond or not to respond to the view that there are a few differences between the contracting options in terms offered by the corporate processors and the farmer-owned cooperatives. This is your chance to put anything on the record should you wish to.

The ACTING CHAIR: Or you could take it on notice.

Mr McNAMARA: There is no way we would know what the corporate processors have in their contractual arrangements, so I cannot answer that in a true way. That might very well be the case, but I cannot answer that. We use an in-confidence clause—confidentially. The retailers would just never share that with us, nor should I want them to.

The Hon. JOHN GRAHAM: No worries. I am just giving you the opportunity to put anything you want on the record. They have put this view on the record. You would be welcome to respond, but thanks for your comments.

Mr McNAMARA: I think the only thing that I would say is that the retail sector have not negotiated with us in fair ways and fair terms. I think the difficulties with the industry as a whole is how you actually move away from or seek incremental price increases to recover the cost increases that occur not only in your business but also on the farm sector. The challenging thought that the industry has is this competitive nature within the retail sector or this duopoly that we pretty much have in the retail sector. The reality is if Norco lost its relationship with Coles tomorrow, we would drop our milk price somewhere between 4¢ and 5¢ a litre.

The ACTING CHAIR: Thank you very much. I believe you took one or two questions on notice.

Mr McNAMARA: Yes.

The ACTING CHAIR: The Committee has resolved that responses should be within seven days. The hardworking Committee secretariat will be in touch with you to talk to you about how to do that. Thank you very much for your submissions and your testimony today.

Mr McNAMARA: Thank you.

Mr JEFFERY: Thank you.

(The witnesses withdrew)

(Luncheon adjournment)

MARCUS BEZZI, Executive General Manager, Specialised Advocacy and Enforcement, Australian Competition and Consumer Commission, sworn and examined

GABRIELLE FORD, General Manager, Agriculture, Advocacy and International, Australian Competition and Consumer Commission, sworn and examined

The ACTING CHAIR: Would either of you like to make a short opening statement?

Mr BEZZI: In fact, we would both like to make a very short statement. In October 2016 the Australian Competition and Consumer Commission was asked by the Australian Government to conduct an inquiry into competition in the dairy sector. This was, in part, in response to the decision by major dairy processors in April 2016, retrospectively to reduce the price they paid to farmers for fresh milk.

The ACCC published its final report into this market study on 30 April 2018. The ACCC's inquiry covered a vast terms of reference, requiring the ACCC to examine all levels of the dairy supply chain and other factors such as the impact of export markets on Australian farmgate prices and profits. The ACCC's inquiry identified a range of market failures resulting from the strong bargaining power imbalance and information asymmetry in farmer-processor relationships—mainly the manner by which price information is given to farmers, and risk-sharing in milk supply arrangements between farmers and processors. These industry features have been present since the industry was de-regulated and transitioned away from farmer-based cooperatives, and they have not corrected over time.

They result in practices which ultimately cause inefficiencies in dairy production. We made eight recommendations for improved transparency and allocation of risk in the commercial relationship between dairy processors and farmers. The most significant recommendation was that a mandatory code of conduct be introduced to address these market failures. One of the issues subjected to considerable analysis during the dairy inquiry is a matter of ongoing debate in the sector—namely, the impact of private-label milk on the farmgate price. The inquiry's final report addressed this issue directly, finding that, "the farmgate price paid to farmers for milk used to fulfil private-label milk contracts is not directly correlated with private-label milk retail prices".

We appreciate that for many farmers, this is a surprising and disappointing conclusion. The ACCC understands and respects the concerns of many people that pricing milk at $1 a litre devalues the hard work that goes into dairy farming. One dollar is an arbitrary price that has no direct relationship to the cost of production of milk by farmers and processors. A key finding of the inquiry was that almost all contracts for the supply of private-label milk allow processors to pass through movements in farmgate prices to supermarkets. In addition, farmers are paid the same price irrespective of whether their milk goes into private label or branded products. These findings were based on detailed evidence provided by supermarkets and processors.

Ultimately, we found that farmgate prices in central and northern New South Wales and Queensland are largely a reflection of competition between processors and the overall local demand for raw milk, with a number of processors often supplementing local production with milk transported from southern dairy regions. Due to the impact of export markets on these southern regions, the practice of transporting milk north is likely to be more prevalent when export demand is relatively weak.

We found that farmers' lack of bargaining power means that they are unlikely to benefit from an increase in the retail or wholesale prices of private-label milk or other dairy products. This is because even if processors were to receive higher wholesale prices from supermarkets, they will only pay farmers the minimum farmgate price needed to secure the volume of milk they require to meet their contractual obligations. This leads in to the reasons that we recommended the mandatory code. If it effectively addresses the issues we have nominated, it will bring about changes in the sector that will mitigate some of the negative consequences of the processor-farmer bargaining power imbalance, and may over time lead to greater competition between processors for farmers' raw milk.

My colleague Ms Ford will describe the ACCC's recommendation for a mandatory code and the process that the Government is currently conducting to develop a code. Before I hand over to Gabrielle, I would like to note in relation to terms of reference (d)—relating to the role of government in addressing key economic challenges to the industry—that the Federal Government's response to the Harper Review on competition policy included amendments to the Competition and Consumer Act that make collective bargaining easier. That includes the process of smaller businesses notifying the ACCC or obtaining authorisation for an intention to collectively bargain with larger businesses; and also for applications for class exemptions.

The dairy sector is a sector that has used collective bargaining successfully in the past, and we think that these amendments have the potential to make it easier for them to use those provisions in the future. Similar to the mandatory code, those provisions help to even-up the bargaining power and get rid of some of the market failure that we are seeing in this market, and have seen over time.

The ACTING CHAIR: Perhaps you could hand up your notes.

Mr BEZZI: Yes, I will.

Ms FORD: I just wanted to talk a bit about the mandatory code recommendations and explain it to you because I think it is relevant to the fourth term of reference for this inquiry. Our final report identified a number of issues that could be addressed through a mandatory code of conduct for the dairy industry. The key aim of it is to improve competition between dairy processors. We are pleased and welcome the announcement by the Federal agriculture Minister to start consultation on a mandatory code of conduct for consideration by the Government—in the New Year, we think. If I may, I will briefly outline the key aspects of what we recommend ought to be covered by a mandatory code.

First of all is to address concerns about aspects of milk supply arrangements between processes and farmers that we think unreasonably restrict farmers' ability to switch between processors in relation to things like loyalty bonuses and the timing of how they are offered and paid. We have some concerns about the ability of processors to unilaterally change key trading terms in milk supply contracts and we believe that could be addressed through code requirements. We think there is an absence of effective dispute resolution mechanisms for farmers, namely, there really is not a mechanism at the moment. We would be eager to see one developed underneath the mandatory code of conduct, which is independent of processors and allows easy access by farmers to that process. There are some recommendations about conducting business between farmers and processors on a good faith basis.

Our process is to assist the Government in its development of the code where we can. The Department of Agriculture and Water Resources is leading the consultation and it started last week. It will continue for the next few weeks. They are preparing a regulation impact statement to weigh the costs and benefits of a mandatory code of conduct. We could go into more detail if you have questions about possible obligations that could be included in a code, but a key thing to note is that we do not recommend that farmers be required to lodge particular documents or business records under the code that we recommend. We want to stress that the code recommendation and the obligations we think are needed are focused on processes, but largely on their existing business practices and making those more transparent. We believe that it should not introduce a high level of regulatory burden into the industry and costs into the industry.

Mr BEZZI: I suppose the take-out of that is that we think that the net effect of the cost of the code would be positive rather than negative. The benefits would outweigh the costs substantially.

Ms FORD: Thank you.

The ACTING CHAIR: Do you have a prepared statement?

Ms FORD: Yes.

The ACTING CHAIR: If you give that to the secretariat, they will organise for a copy to be made.

Mr BEZZI: It is included in what I handed across.

The Hon. JOHN GRAHAM: Thank you for your appearance and your evidence. It is certainly helpful, given all the work you have done. Just on that final point about consultation on the code, when do you expect that will be concluded? What is the timing of that conclusion and the next step?

Ms FORD: It is the department's process, but my understanding is that it should be concluded in the next week to two weeks and that preparation of a regulatory impact statement and drafting of the code will happen concurrently. It is a reasonably prompt process building on the work that we have done and also that the industry has done about its voluntary code.

The Hon. JOHN GRAHAM: Secondly, I accept the characterisation you have applied to your own work as accurate in that the farmgate price is not directly correlated to the price of the private label milk. I am interested in what you think of the evidence that has been put by the New South Wales Government's submission that characterises your findings in this way: They have said that you have concluded that the Australian farmgate milk prices were predominantly influenced by international prices. Do you think that is a fair characterisation of where you ended up, or do you think that is a simplification?

Ms FORD: It is mostly fair. I would say yes because the bulk of the Australian dairy industry is concentrated in the southern regions of Victoria, South Australia and Tasmania, and that includes southern New South Wales where prices are very strongly influenced by global factors. In northern New South Wales and Queensland, the effect is still there but it is less than in those southern areas because of the flat ongoing demand for fresh milk, which drives the industry and pricing in those States, but it does still have some influence on the prices.

The Hon. JOHN GRAHAM: The next question is that the Farmers Association gave evidence this morning. They have been quite critical of some of the work and some of the conclusions. Clearly there has been ongoing dialogue between you about this work. I would be interested in the view of the ACCC regarding those criticisms that have been directed at the ACCC.

Mr BEZZI: We were not here this morning so we do not know what the criticisms were this morning.

The Hon. JOHN GRAHAM: I presume there has been an ongoing dialogue though, or have they not put those views to you?

Ms FORD: Throughout the inquiry we had dialogue with the NSW Farmers Association. We are aware that they take issue with our $1 milk assessment and the way we have analysed it.

The Hon. JOHN GRAHAM: Do you want to put anything on the record in response to their suggestions?

Mr BEZZI: What specifically were the suggestions this morning?

The Hon. JOHN GRAHAM: The two things I would draw out are their view that a focus on fresh milk was particularly important and that might lead to some different conclusions. Overall—I would say the very highest level, really—their criticism is that your finding is very strong when it comes to the farmer-processor relationship but you have let the retailers off the hook. That is probably the highest level way to put that view.

Mr BEZZI: Yes. That criticism has been made. I should say that we had the benefit of the use of compulsory powers to require the production of data. We collected a huge amount of material. If was that evidence that we use to form our view. I think it was a very thorough process that we had. We certainly went into the process with a very open mind. I remember we certainly discussed that opinion with NSW Farmers; but, really, when you look closely at the evidence, it is very, very hard to escape the fact that the farmgate price seems to be determined by demand within the area.

The Hon. JOHN GRAHAM: Within the region, yes.

Mr BEZZI: And the farmgate price can be passed through to retailers directly.

The Hon. JOHN GRAHAM: You really found that those pass-through provisions are really present in almost all of these contracts.

Ms FORD: Yes, they are.

Mr BEZZI: Yes.

The Hon. JOHN GRAHAM: That is enabling a genuine pass-through. Over time, other pressures come to bear, but you think that is operating as a genuine process.

Mr BEZZI: But the more important issue—and my colleague will add to this because she has a more detailed knowledge than me on aspects of this—is going the other way. Let us assume that the retailers paid the processes a lot more money. There would be no obligation on the processors to pass any of that back to the farmers—absolutely none at all.

The Hon. JOHN GRAHAM: In fact, your findings are stronger than that. It is not that there is no obligation; it is that it would not happen because of the nature of competition.

Mr BEZZI: It would not happen because of the imbalance in the market position between the processors and dairy farmers. There seems to be this fairyland-type assumption that, somehow, if retailers paid processors more the money would go to farmers. That is just not the way the market works.

The Hon. JOHN GRAHAM: Would you be open then to one of the suggestions of the NSW Farmers Association, which on the face of it looks pretty sensible, that the New South Wales Government engage a farmers' advocate—they have a couple of ways to describe it—who would be responsible for raising some of those competition issues, potentially in a formal way within the Commonwealth system with the ACCC and other bodies to advocate on behalf of farmers and to run cases when possible to use the competition laws to their full effect in this sector? Are you open to that sort of recommendation from this Committee or that proposal from the Farmers Association?

Ms FORD: We agree that advocacy for farmers is always welcomed and that strong representation is a good thing for the functioning of the industry and the economic performance of the industry. I would add that that is one of the key roles of the ACCC agriculture unit and one of reasons the unit was established. We have a commissioner with special expertise in agriculture who is now one of the deputy chairs of the ACCC. We take that role really seriously. We are very committed to it. We would continue to advocate for competitive markets and addressing problems with bargaining power imbalances when we see them to be problematic, as we have.

Mr BEZZI: We think that the most powerful intervention that could be made at the moment is the mandatory code, which really tries to even up that power relationship.

The Hon. JOHN GRAHAM: This does not necessarily cut across that or contradict any of your eight recommendations. What do you say to the view they put to us—which, I have to say, I was quite alarmed by—that more farmers have been prosecuted than processors or supermarkets because the ACCC has lent more heavily on the misleading and deceptive conduct provisions?

Ms FORD: We do not accept that characterisation at all.

The Hon. JOHN GRAHAM: You would reject that characterisation?

Mr BEZZI: I do not think the evidence would support that.

The Hon. JOHN GRAHAM: A commissioner who advocated into your processes and put cases forward would not necessarily trip across what you are doing, would it?

Mr BEZZI: We welcome any input from anyone at anytime. We have formal processes for getting input from people and organisations like the NSW Farmers Association. They participate in our agriculture consultative committee and are very active participants in that committee. But we welcome any input from people at any time.

The Hon. JOHN GRAHAM: Finally, can you tell us briefly how extensively you used the powers to call on information in the inquiry?

Mr BEZZI: Ms Ford might be in better position to give you a general idea but if you want very detailed information—

The Hon. JOHN GRAHAM: I want a sense of the scope of the use of your powers to inform this report.

Ms FORD: Every single major processor—there were one or two very small niche ones that we did not use the powers to obtain information from—was the subject of compulsory information and document requests, as were the major supermarkets. We gathered data going back more than 10 years to try to find the before and after effects of $1 milk. That was a very detailed process. We had to push hard and we are satisfied that we got what we need from all of those businesses.

The Hon. JOHN GRAHAM: I am conscious of my colleagues. If you wanted to provide anything else on notice that would be fantastic. But that is useful.

Ms FORD: Just one thing, they were also subject to cross examination under oath by council for the ACCC, which was very rigorous.

Mr BEZZI: They were examined. We brought people in and examined them in private.

The Hon. RICK COLLESS: Thank you for coming in today. As I am sure you are aware, this is a very delicate issue that we need to try to work our way through. When you talk about the evidence that you were given, who was that evidence from? What evidence did you take?

Mr BEZZI: It was the evidence that Ms Ford was just referring to.

The Hon. RICK COLLESS: Yes, but from who? Who provided that evidence to you?

Mr BEZZI: Basically the whole industry.

The Hon. RICK COLLESS: So it came from all sectors of the industry, including the producers?

Mr BEZZI: Mainly the producers. We had very extensive compulsory notices that required the production of data. We also required people to come and give evidence to us. People were examined in the course of that process. We got evidence from retailers. We obtained evidence from a whole range of people. We had submissions from farmers. We held information sessions where we collected information on the ground in dairy farming communities. There was a very extensive evidence-collection process.

Ms FORD: I would like to clarify one thing. The information we got from farmers was obtained voluntarily. The formal information powers are quite a strong and heavy tool and we did not think it was necessary or reasonable to use those against dairy farmers.

The Hon. RICK COLLESS: While you were collecting that evidence did you take evidence from the producers themselves about their farmgate prices and the cost of production on a per litre basis and what sort of parameters were in the cost of production?

Ms FORD: We obtained that data mainly through Australian Bureau of Agricultural and Resource Economics and Sciences [ABARES] data. We did speak one on one with farmers through those public forums and throughout the inquiry in letters and phone calls. But we felt that the best sample was that which was already collected by ABARES when it came to farm profits, costs and revenue. We did take data from the processors about actual prices paid to farmers. We did get that granular information as well.

The Hon. RICK COLLESS: We have heard a lot of evidence over the last couple of days of this inquiry that the costs of production are, in a lot of cases, in excess of what farmers are receiving at the farm gate. In a lot of cases it does not include a proper recompense for the wages of the family group that contributes to that business. That indicates to us that the cost of production is much higher—at least 10¢ per litre higher—than what farmers are receiving at the farm gate. You say that the price at the farm gate is not affected by $1 milk, but farmers are getting between 40¢ and 50¢ in a lot of cases at the farm gate.

We heard evidence this morning from Norco that it passes its milk on to the retailers at about 90¢ a litre. There is not a lot in it for the retailer. In the case of Norco, all the profits go back to the farmers. It is not in it to make money; it is a cooperative. Where is the issue here? Why is there a situation where an industry is receiving less for its product than the cost of production, while the retailers at the other end are continuing to try to drive those prices down to a dollar a litre?

Ms FORD: The $1-a-litre price has stayed flat since 2011.

The Hon. RICK COLLESS: Before that it was $1.60.

Ms FORD: For the price of milk?

The Hon. RICK COLLESS: The retail price of milk?

Ms FORD: Yes, but what our analysis showed was that the farmgate price is not lower today than it was when dollar milk was introduced.

The Hon. WES FANG: It is not substantially higher though, is it?

Ms FORD: No, it is not.

The Hon. RICK COLLESS: It is not higher at all?

Ms FORD: No, I do not mean to give the impression we think that things are not very, very tough at the farmgate level but farm profits have moved around quite a lot over that last 10 or nearly 20 years since deregulation. There have been a lot of farm exits since deregulation. A lot of the issue is that costs have been quite high at times and that has been the main driver of profits or not profits throughout that period. The main cost driver is the cost of hay or fodder, which has spiked quite a lot over those years.

Mr BEZZI: Particularly at the moment with the drought.

The Hon. RICK COLLESS: Yes, and we are trying to look at this outside the impact of the drought for obvious reasons that the drought will not last forever, hopefully. At the moment, irrespective of the drought, the cost of production is, in many cases, still higher than what they are getting at the farm gate.

Ms FORD: Yes.

The Hon. RICK COLLESS: You can understand the concern of these people; you can understand the concern of the Government and anybody who is involved in the industry about why that is happening. How do you see that farmers can receive a fair and proper price for their product when we have retailers at the other end keeping an artificially low price on the product, given that internationally, as I understand it, in New Zealand the minimum retail price is about $NZ2 a litre, which is about $A1.85? If we are impacted by the international price of milk, why would our minimum price not be somewhere around that $1.80 or $1.90 a litre?

Ms FORD: I think it goes back to what Mr Bezzi said earlier, which is that the farmgate price, when it comes to $1-a-litre milk, is essentially isolated. It is not negotiable between processors and the supermarkets. If the supermarkets lifted their price it would not affect that. If they lifted or changed their retail price, it would not affect what happened at farmgate level. In our opinion the key driver of that farmgate price is global conditions, yes, but domestically the level of competition between processors—

The Hon. RICK COLLESS: But we are talking about fresh milk. Fresh milk, generally speaking, is not an exportable product; it may be, but it is not generally regarded as an exportable product whereas cheese, butter, powdered milks and all the other products are exportable, which are impacted by the international price—

Ms FORD: Yes.

The Hon. RICK COLLESS: —yet the biggest component of the dairy industry in New South Wales is fresh milk?

Ms FORD: Yes.

The Hon. RICK COLLESS: And it is the one thing that is not impacted as much by international prices?

Ms FORD: That is true but I think the farmgate price is mainly impacted. There is not as much competition in New South Wales, and northern New South Wales especially, as there is in southern regions between processors.

The Hon. RICK COLLESS: Are you talking about for fresh milk?

Ms FORD: For fresh milk, yes.

Mr BEZZI: Producers generally do not have much choice and they are often locked into a particular processor and it is just impracticable for them to move.

The Hon. RICK COLLESS: I understand that.

Mr BEZZI: What we are trying to do through the mandatory code is to give them more choice and put them in a stronger bargaining position so that they can negotiate better farmgate prices.

The Hon. RICK COLLESS: I think all of us here agree there should be competition in the market but at the moment there is not competition in the market; the market is being regulated by the retailers—

Mr BEZZI: And the processors.

The Hon. RICK COLLESS: —and the producers have absolutely no capacity to compete other than through their own farm efficiencies?

Mr BEZZI: You have got to look carefully at the processors as well. Processors have got an enormous amount of power in this market. The larger processors are very large multinational companies. They do not have a lot of sympathy for particular farmers in particular areas. Their commitment is to their bottom line, which is entirely right from their perspective, but they are economic entities out to maximise their profit and they do that by keeping farmgate prices as low as they possibly can within particular geographic areas. That is the problem. They have got the power to do that and that is why we think a mandatory code is so important because it will even up the power so that producers can have a closer amount of power to the processors; they can be more evenly balanced.

The Hon. RICK COLLESS: I hope you are right because we need to put some sort of breaker in the system somewhere to make sure that producers remain competitive enough to stay in the industry. It looks like it may not happen.

The Hon. WES FANG: Thank you for coming in today. It has been illuminating so far. You said that in the inquiry you were able to look at historic data and this is the bit that I find puzzling. We heard testimony this morning that we had production in New South Wales of around 11 billion litres and we have seen that reduce now to about eight billion litres. There has obviously been a reduction in the supply of milk into the market. Prior to 2011 we saw a retail price of around $1.60 a litre and we have seen the advent of a dollar milk. When we spoke earlier about the farmgate prices, you said they have not substantially fallen but they have not substantially risen either; they have effectively been flatlined.

Ms FORD: They move up and down.

The Hon. WES FANG: In effect, the farmgate price, on the graphs that I have seen after deregulation have similar cents per litre to what they were prior to 2011. There has not been a lot of movement—some cents, but not much. How is that possible when the costs for farming are going up, the CPI is going up, the retail price is going down and the volume is going down. There is less volume and more competition yet farmers are not benefiting from that. Where is the disconnect?

Mr BEZZI: I think there is more production per farm now than there was.

The Hon. WES FANG: But there are fewer farms?

Mr BEZZI: Yes.

The Hon. WES FANG: People are leaving the industry?

Mr BEZZI: Yes.

The Hon. WES FANG: So we have seen a 30 per cent reduction from 11 billion to eight billion in the amount of milk that New South Wales produces. Therefore, we should see an increase in competition for that volume. If we had 11 billion litres before, a retail price of $1.60 and people were paying a round figure of 50¢ per litre at the farm gate, and we have now got eight billion litres—a lot less with the same farmgate price, with higher costs, where is the disconnect? Why is there a lack of competition? You keep saying that the market—

The ACTING CHAIR: Could you allow the witnesses to answer your long question?

Ms FORD: Yes, I might need you to go back and break down some of it. New South Wales, especially the northern parts, has quite a tough market because the costs of producing milk are higher and the processors in that area relative to their southern rivals do face higher costs and that, plus the size of the milk pool, may constrain how much competition you can have sustainably to sustain more processors. That is one economic factor. Then there are some other factors like the ones we have been focusing on a little bit more with our inquiry and our recommendations. There are some barriers to switching, which means that the level of competition can get a little bit stale. That is something we would like to stimulate more through lifting some of these barriers that farmers face.

The Hon. SCOT MacDONALD: Market failures in agriculture are not unusual in terms of commodities and how they work. You talk about information sharing as well. I understand what you say about the code of conduct, but is there a realistic hope that you can address those market failures?

Ms FORD: Yes. We looked at our code recommendation through that market failure prism to ask ourselves and test our thinking: Is it worth it, what we are recommending here? And the reason we think it is worth it is that, to use a cliché, information is power. We do not pretend that it will eliminate the bargaining power imbalance but we think there are failures in information that limit farmers ability to make—

The Hon. SCOT MacDONALD: Timely?

Ms FORD: —the best possible business decisions they can, and we think that is where the inefficiency or the market failure is. I would not say it is revolutionary but we think it is important enough to put farmers in a better position when they are dealing with these big processors to have a better standing.

Mr BEZZI: To give you an example, at the moment processors can retrospectively step down the amount of money they pay to farmers.

The Hon. SCOT MacDONALD: Which we saw with Murray Goulburn.

Mr BEZZI: We think that is something that only arises because they have got market power that enables them to do that. We think it is a completely impossible situation for a producer to be put in to be faced with that retrospective set down. It would be like the New South Wales Parliament saying to you, "We are backdating your salary and it is being reduced by 30 per cent."

The Hon. SCOT MacDONALD: "And, by the way, we are going to ask you for the money back."

Mr BEZZI: Yes, "And give us the money back straight away please." That is the sort of thing we think needs to be addressed in a code. It is a basic piece of fairness really that is only possible because of the imbalance between the two entities.

The Hon. SCOT MacDONALD: Part of the issue that I see—as you say, information symmetry—is very little of it is in a spot market. Most of it is a contract for a period of time. It is not like a farmer can be on his or her mobile phone and say the price at the moment of white milk is at such and such; butter fat, or yield, or whatever it is, is so many cents, and you can trade. They are not in that position. Are there possibilities to empower them? Is that what you are going to try to do?

Ms FORD: Yes. We want the timing of price announcements to be more timely, relative to when a farmer is expected or needs to sign up to supply a processor, or to decide whether to change processors. We think they need to be given that key income information sooner, earlier than they do now. We know that for processors there are variables that change for them too, but we think they are still in a better position than farmers and could share that earlier. I think one of the powerful findings from our analysis was about loyalty bonus payments. Sometimes they are withheld, unless the farmer commits to supplying in the future years.

The Hon. SCOT MacDONALD: That is really a gun to the head.

Ms FORD: That is a critical switching barrier, we think. And the withholding of loyalty bonuses, the powerful piece of analysis I refer to, for many farmers that is the difference between a profitable year or a non-profitable year.

The Hon. SCOT MacDONALD: Switching tack a bit, the Committee heard at Moss Vale that there were concerns about the viability of the processing industry as well. We are talking about the dairy farmers and their concerns about the sustainability of that. There were a number of people there who said that they are concerned, strange as it might seem, about the viability, sustainability of the processing industry. There have been a number of sales, buyouts, mergers, et cetera. Are they realistic concerns? Do you see a concentration of the processing sector?

Ms FORD: From the inquiry that was not a concern that revealed itself to us.

Mr BEZZI: There were some processors that were smarter, better organised, taking better advantage of business opportunities that are out there than others. Some, when they gave evidence before us, we thought how do they organise themselves to do anything. There are clearly poor operators in that sector. But there are also some very, very impressive processors. Some are focused on innovative products, adding value, going into ice cream, going into yoghurt, really improving the profitability of their concerns by doing innovative things. It was quite inspiring actually to hear from some of them.

The Hon. SCOT MacDONALD: You are not concerned about concentration of processors?

Ms FORD: We are somewhat concerned about concentration. There are some regions, northern New South Wales is one, where there is not a lot of competition. Western Australia, certainly. It is a small market though.

The Hon. SCOT MacDONALD: For everything though.

Ms FORD: Yes, and even in the most competitive market, Victoria, we still thought that the combination of Murray Goulburn and Saputo was significant enough to have a detrimental impact on farmgate price if that were to go through as it was originally proposed. It originally was approved on the condition of some divestitures.

Mr BEZZI: This is a merger between Saputo and Murray Goulburn.

The Hon. SCOT MacDONALD: All this information informed me about future requests for sales and mergers.

The Hon. WES FANG: This Committee is inquiring into the sustainability of the dairy industry in New South Wales. Did you have any ability to look at the sustainability of the industry at all, or were you just looking at the regulations?

Ms FORD: We did not look directly at the sustainability but we did get an overall picture of the health of the industry that is on the whole positive, but is very tough. What I mean by "on the whole positive", there are still a lot of viable processors. In some regions in particular farmgate profits have improved since deregulation, not everywhere.

The Hon. WES FANG: Forgive me for looking a little bit shocked. I think the ACCC must be the only organisation that thinks that the dairy industry at the moment has a positive outlook. Where is that disconnect again? Not one piece of testimony that we have had to this point has indicated that there is a positive outlook for the dairy industry in its current shape.

Ms FORD: I think that we have had a very, very detailed analysis of the length and breadth of the industry. What I am saying by positive is we do not see any really red flags that the industry is failing. But—

The Hon. WES FANG: Do you think that a red flag may be that the farmgate price—I am genuinely worried. You are the ACCC and it is your job to ensure that there is fair and reasonable competition within the market. All the testimony we have had to date is that the market is skewed against the farmers who are producing this milk and selling it for—particularly now with the drought—a price a lot less than it costs them to produce, and that the processors are also being screwed down by the retailers who are selling it at $1 a litre. The ACCC's testimony is that the outlook is rosy.

Mr BEZZI: No.

Ms FORD: We did not say that. But I think we would agree that there is a big imbalance in power between processors and farmers, definitely. The major supermarkets are very powerful. It is tough business. But, on the whole, the processors are profitable.

Mr BEZZI: Not just profitable; some are doing very well. Some are very attractive businesses. Saputo has just bought Murray Goulburn. The picture across the processing sector is not identical; there are different firms that are taking different advantages of different aspects of the sector. However, we do agree with your assessment that, as a rule, farmers are doing it tough. That is why we have come up with our very strong recommendation in relation to the mandatory code.

The Hon. WES FANG: Yet we still have farmers selling their milk at a loss 12 months after your inquiry was started. Where is the failure? There is a failure; is there not?

Mr BEZZI: The code has not yet been implemented.

The Hon. WES FANG: Why not?

Mr BEZZI: We recommended it in April. It is not within our power to implement it; it is for the Federal Government to implement it. Our job is to make a recommendation and then support it by explaining why it is good, and we have been doing that. I think there is widespread support for it. Frankly, there was opposition to it from some processor-supported elements within the industry, if I can put it that way. However, there is now a general consensus that we are detecting in favour of our recommendation. It is not in force yet, and it cannot do its work until it is in force.

The Hon. WES FANG: I think it is taking a bit too long. What role do the retailers have in all of this? Do we need to strengthen the regulations around what the retailers are doing in this space? Reading your report, and to paraphrase the Hon. John Graham, I think the retailers are getting off scot free. We have heard today that they are big players in this and are responsible.

Mr BEZZI: We certainly agree that they are a big player and that they have very substantial market powers. We also agree that their position needs to be addressed. It is addressed in the Food and Grocery Code, which was reviewed by our former chairman, Mr Graham Samuel, who made certain recommendations. The Government has asked for further submissions on those recommendations. We do not agree with a number of the recommendations; we think there should be a stronger food and grocery code to deal with some of the market power issues in relation to retailers. We will be making a detailed submission explaining why we think Mr Samuels got it wrong.

The Hon. WES FANG: The thing I hate most about government is talking about submissions, codes and so on.

Mr BEZZI: They are the tools we have to use.

The Hon. WES FANG: There is a massive disconnect between what is happening in that space and at the farmgate now. That is a problem. Do you think we may need to reregulate? Is that an answer to the problems we have?

Mr BEZZI: We do not think so. We think that would ultimately be the way to kill the industry.

The Hon. WES FANG: Why?

Mr BEZZI: Because the industry operates largely within a world market, and we cannot regulate the world.

Ms FORD: It is about maintaining competitiveness.

Mr BEZZI: We must be competitive. If we try to establish an industry behind a wall, it will not be an innovative, competitive industry that can take on international markets. That is future for it.

The Hon. SCOT MacDONALD: It is not the wool industry in the 1980s.

The Hon. WES FANG: For it to be competitive, it must be sustainable, and at the moment I do not think it is.

The Hon. MARK PEARSON: I understand that the Australian Competition and Consumer Commission, apart from other things, applies the question of misleading and deceptive conduct. Is that correct?

Ms FORD: That is one of the key provisions in the Act we enforce.

The Hon. MARK PEARSON: Has consideration been given to broadening to it to include unfair and improper conduct?

Mr BEZZI: Unfairness is picked up; there is a number of ways in which that is done under our legislation. For example, there are prohibitions on the use of unfair contract terms in standard form contracts. Unfairness is also picked up, in a sense, through provisions in the Australian Consumer Law relating to unconscionability. It is a contravention of that law to behave unconscionably to another business if—

The Hon. MARK PEARSON: But is that not what some of the processors are doing to the farmers?

Mr BEZZI: No. We have looked at the particular scenarios. Murray Goulburn was an unconscionable conduct case. That provision was useful when we looked at that case, and we used it in relation—

The Hon. MARK PEARSON: Was it a helpful test case for this question?

Mr BEZZI: Yes, I think so.

Ms FORD: To put it in a general sense, the test of unconscionability that courts have articulated over the years is that the conduct goes beyond what is reasonable or legitimate for conducting business.

The Hon. MARK PEARSON: If the processor is making the main profit between the retailer and the farmer, but the farmers' business is dying, directly or indirectly as a consequence of that conduct, surely the community would see that as improper and unfair?

Ms FORD: The focus is on the conduct itself and whether it goes beyond what is rational or reasonable business behaviour. A court would focus on what was that conduct.

Mr BEZZI: Using the Murray Goulburn example, it created an expectation that suppliers would, on average, receive a minimum price of $5.60 per kilogram and a likely full-year price of $6.05 per kilogram. It would also update the full-year forecast to reflect material changes, and it continued to make those representations. Our case was that essentially it had no basis for making those representations; that is, it was creating an expectation that it could not deliver upon and it was unconscionable to do so. That is paraphrasing a complex set of pleadings, but essentially that is what it did.

We also say that it engaged in false or misleading representations in connection with the supply of milk. In that case, because at the time it was a grower-owned cooperative, we decided not to seek penalties against Murray Goulburn. However, we have sought penalties against Mr Gary Helou. That matter has now been resolved subject to the approval of the Federal Court. The court will be looking at whether it should give that approval at a hearing on 6 December.

The Hon. MARK PEARSON: Would it be helpful if it goes your way?

Mr BEZZI: Subject to the judge being satisfied that we have established a sufficient basis for him to make the determination, it will be a wrapping up of the resolution that we have reached with Murray Goulburn and Mr Helou. In other words, various orders will be made against Mr Helou and Murray Goulburn.

The Hon. MARK PEARSON: Will this case help the dairy farmers?

Mr BEZZI: I think in the sense that it establishes a precedent for a finding of unconscionable conduct against a processor. If we see this sort of conduct in the future, we can say to processors, "Look what happened to Murray Goulburn. We didn't go after a penalty in relation to them in that case, but we may do so in relation to you." The penalties have just been increased from $1.1 million per contravention to $10 million per contravention, three times the benefit or 10 per cent of turnover within Australia, whichever is the highest. They are now very substantial penalties. That is another thing that I think should help to readdress the imbalance between processors and producers to some extent.

The ACTING CHAIR: Thank you for appearing before the Committee today.

(The witnesses withdrew)

PHIL RYAN, Dairy Farmer, Bega, sworn and examined

The ACTING CHAIR: Would you like to make an opening statement?

Mr RYAN: I would like to make a short statement.

The ACTING CHAIR: Go for your life.

Mr RYAN: I am representing Bega and the dairy farmers in the Bega area. We are a little bit different to most of the New South Wales industry in that we primarily—or exclusively, really—supply cheese processor rather than a fresh milk processor. There are now approximately 60 farms left in the Bega Valley, supplying Bega Cheese. I guess I have some slightly different things to contribute than the rest of the New South Wales industry. I am here following some significant community support from things I have posted on Facebook, which came about through being forced to sell cows during the drought because I was losing a lot of money.

I started this year with plans to invest in a new dairy, which are on hold indefinitely until my business looks profitable enough to justify a 15- or 20-year future investment. It has become somewhat standard to accept that dairy farmers do not make a reasonable return on equity or their assets, that we do not make a reasonable return on the amount of hours that we work each and every day. This represents probably the seventh day this year that I have not worked on farm. A lot of those are 15-plus-hour days and I am not alone. We have just heard from the ACCC and I do not agree with quite a lot of their findings. They refer to the contracts for private label milk having "pass through" clauses from processors to pass on farmgate price increases. They have only ever referred to contracts for private label milk; they have not referred to contracts for other dairy products and they have not referred to contracts for branded milk.

I would love it if they could clarify their position because I supply Bega Cheese and I do not believe that they have a provision to pass on farmgate price increases to supermarkets. They talk about us being exposed to an international market. Well, that historically was probably quite valid. When our production was in excess of 11 billion litres nationally and we were consuming five billion litres domestically and had very few imports, that would have been a valid assessment. We are now looking at producing somewhere in the order of 8½ billion litres, give or take how much production falls this year. We are consuming six billion litres worth of product domestically. We are importing somewhere in the order of three billion litres worth of product. That means that our domestic market is the primary driver of returns to farmers in Australia.

Yes, we can import cheese and we can import butter—and we are. That is at a cost to Australian farmers. But the retail marketplace is, in my mind, the primary means of adding value to the supply chain for dairy farmers, in particular in New South Wales. It is not just milk, it is all dairy products. They sell cheese for $6.60 a kilo. That is an equivalent milk price of 66¢ a litre. It is far more devalued than $1-a-litre milk, but it does not get a lot of headlines. That is what limits what my processor can pay me. It is that market for cheese and other dairy products, as opposed to the fresh milk market. I think that is a really important thing that we cannot miss. Some of the things that need fixing in the dairy industry are not in New South Wales only; they are national issues. Part of the support that I think we need from you is to pass on some of the findings from this inquiry to Federal colleagues and to help us make changes that are required on a national level.

I did not have time as much time as I would have liked to put together my submission. One of the things I have since come across are suggestions for a New South Wales milk commissioner or a similar position. It is something that I wholeheartedly endorse. The ACCC implied that dairy farmers were not equipped to make informed decisions because of lack of access to information. I do not think that that portrays us very fairly either. We did have access to most of that information. It was not necessarily easy to get but I was certainly aware of most of the global milk price issues and other things that they are saying we were not aware of. I was also privileged to have weather forecasts that predicted that this year would be a wetter-than-average winter in south-eastern Australia, which is one of the things I base my business decisions on. It has clearly not come out that way.

Mandatory code of conduct is not going to materially affect farmgate price. It is not the solution to our industry's problems. It may well help. It will help with some of the really big problems, like the Murray Goulburn Fonterra stepdown scenario. It might help in moving between suppliers to processors and the like, because most of us are contracted for fixed terms for our supply. They are two big areas where it will help, but it does not include supermarkets. As I articulated earlier, I clearly believe that that is the primary means of adding value into the supply chain. Without including retailers and the retail market as a means of adding value to our products, the code of conduct would not help as much as it should. There is clearly a problem, as everybody has acknowledged. Farms are going out of business, farms are selling cows, farms are going broke.

Our industry, as it stands, is not sustainable. Our current hay and grain prices will be current until this time next year because there will not be a new grain harvest. Whether it rains in my local area or not, I will be exposed to the same grain price today, which is double what I was paying last year, for the next 12 months. The ACCC referred to us having a world market that we cannot regulate. We can regulate how we interact with that world market. We have imported product from subsidised dairy producers that is coming freely into our market and is competing with our own subsidised product. We do not have very clear labelling on those products that allow consumers to help us.

The ACTING CHAIR: It is a country-of-origin label, is not it?

Mr RYAN: Yes, that type of thing exactly. Things like New South Wales dairy logos and the like have disappeared. These things can help consumers help us and they do not have the easy information to do that. There is a tiny little "Made in USA" or "Product of New Zealand" disclaimer on the back of their butter packet or their cheese packet. That does not let them make an informed decision. We do have their support. That has been shown over and over again. Farmers have the community's support but we do not have a means of engaging with that. Thank you.

The ACTING CHAIR: I am not sure whether you were speaking off the cuff or you had prepared notes.

Mr RYAN: I have a couple of bullet points. They are not suitable to hand over to you to help you out, I am afraid.

The ACTING CHAIR: That is all right. That is fine.

The Hon. MARK PEARSON: We can offer you a job.

The ACTING CHAIR: You have done very well. I thought Mr Scot MacDonald was going to scoot but he is still here.

The Hon. SCOT MacDONALD: No. I thought it was important to listen. Can I ask about your submission on page two? I am just getting to a point that you and other people have made—that your relationship is with the processor, not the supermarket. I guess it is a bit different with cheese versus milk and that sort of thing. Do you see that as certainly part of the issue—that the supermarket is a bit remote from what is happening on the ground at farm level?

Mr RYAN: Absolutely. I have lobbied very hard through social media and other means to try to get a small increase in the retail price of dairy products, but they have no interest in doing so because their business benefits from having cheap dairy products at the back of the store that everybody else walks past. I have no means of forcing my processor to change the price at which it sells product to the supermarket. Bega has domestic and export market exposure and has very strong engagement with us as farmers. I genuinely believe that they are operating on very skinny margins on their dairy products. That is why they have invested in Vegemite and peanut butter and non-dairy assets—because there is a much higher margin in those grocery lines.

The Hon. SCOT MacDONALD: We have seen on beautiful television ads—I think it is mainly for Woolies—where they have got their staff out in the middle of the cabbage farm or avocado plantation, whatever it is. I guess the message is directed to the farmer and therefore the relationship, I assume, is a lot closer—you know, it is about it being profitable and they are aware of the costs. Is there any relationship at all with the end consumer for you or with the retailer and consumer, would you say?

Mr RYAN: Not a financial one. I believe that there is a very strong relationship between me as a dairy farmer and the end consumer as a member of the general public, but it has no bearing on my business.

The Hon. SCOT MacDONALD: On price, or no bearing on profit.

Mr RYAN: No bearing on my business.

The Hon. SCOT MacDONALD: Is there any way you have seen other industries around the world that can be re-examined in some way? If the supermarket is remote for you in your industry, you understand why the care factor might be low. They just deal with the processor. They dial up the order. They get the order into the warehouse and then to the supermarket, and that is all they really care about. As long as they have a good margin and that risk is put back usually on the processor, why should they behave any differently? I guess that is what I am asking.

Mr RYAN: Ethical and moral grounds clearly do not have any bearing on it. They have recently raised the price of beef because of drought-related issues impinging on a quality supply of beef. We have seen a fall in dairy production across the country that is predicted to be in the region of 700 million litres.

The Hon. SCOT MacDONALD: And that will not empower you more?

Mr RYAN: I am opening over time it may, but clearly it is not at the moment. I do not know that it will, unless there is some form of external change that is forced upon our marketplace. At the moment, the retailers have far too much power, in my personal opinion. There are a limited number of processors operating in the market too with two supermarket chains that dominate the domestic market. It only takes one processor to decide that they can undercut everybody else and that drops the floor in the market. We saw that with Murray Goulburn's contracts with Coles. They sold products cheaper than anybody else was prepared to sell them at the time.

The Hon. SCOT MacDONALD: And it destroyed that business, did it not?

Mr RYAN: It was one of the contributing factors to destroying Murray Goulburn.

The Hon. SCOT MacDONALD: I might circle back later. I would like to think a bit more about it, if that is okay.

The ACTING CHAIR: Just before I turn questioning over to the Hon. Wes Fang, in your opening address, Mr Ryan, you said that there are now 60 dairy farmers in the Bega Valley.

Mr RYAN: That is roughly correct, I believe. It was 65 some months ago but I believe that five of them have closed.

The ACTING CHAIR: That is a reduction from what number? Just give us a bit of a picture.

Mr RYAN: It would once have been several hundred dairy farms.

The Hon. SCOT MacDONALD: The same as the Hunter Valley.

Mr RYAN: It was a vibrant dairy farming area. I can probably list 15 or 20 cheese and butter factories in satellite or small towns that have closed in the Bega Valley. For example, the Cobargo Butter Factory had 65 suppliers when it closed in probably the early seventies. There would now be seven farms in that Cobargo region that are now supplying Bega.

The ACTING CHAIR: It is a substantial reduction in the numbers.

The Hon. WES FANG: Thank you so much for coming here today. I know you have come a long way but it is important to hear from people like you in this inquiry, so thank you. We just heard from the ACCC. I noticed that you were in the room when they said in relation to this code of conduct that they are proposing that one of the mechanisms that they think will help farmgate pricing is the ability to switch processors. As you have said, in your region, there really is the one processor and everyone is contracted to Bega Cheese. What ability do you think you would have to take your product and sell it to another processor?

Mr RYAN: Very limited, and none for the next three years because I have signed a contract to supply Bega Cheese to avail myself of a loyalty payment, if you will. I felt I had no choice but to do so. It is one of the few areas that I would complain about in relation to Bega cheese. I think I have got a very good relationship with them as a processor. Parmalat did come down to Bega to look at, essentially, picking up supply from some farms, and that instigated an increase in our farmgate price. That was in Bega's case partly more because they were able to then explain to their Victorian suppliers why we were getting paid more in Bega than they were getting paid in Victoria. Realistically, that is not going to improve things dramatically for me, I do not think; but it may well improve the situation for other dairy farmers around the State and around the country.

The Hon. WES FANG: Have you had a chance to read the ACCC report? It is okay if you have not.

Mr RYAN: Yes, I have.

The Hon. WES FANG: Do you see anywhere in that report that, if implemented, would make a material difference to you in the way that you are paid at the farm gate?

Mr RYAN: Me personally? No, I do not see any way that the recommendations they put forward materially affect what I get paid. I can see how it will materially affect some other areas of the industry. It will particularly prevent some of the things that Murray Goulburn and Fonterra did to cripple some farms. But, no; for me personally, I do not see it particularly being helpful.

The Hon. WES FANG: If you do not mind me asking, are you selling your product at a price which is lower or at cost compared to what it costs to produce?

Mr RYAN: Right at this very minute I would probably be making a small amount of money, but for the vast majority of this year I have been losing a very large amount of money. We had some reasonable rain in the local area in late September and through October and as recently as the day before yesterday. I am currently grazing green grass that I have not had the luxury of doing for most of the year. I am currently getting paid roughly 50¢ a litre for the milk I produce. The cost of production is probably something in the order of 45¢ to 48¢ a litre on that milk, but earlier this year my cost of production would have been in excess of a dollar a litre for some months. While technically I am making money at the moment, over the balance of the year I have lost a lot of money.

The Hon. WES FANG: The concern that I have is that, in your instance and for you and the farmers around your area, the measures that the ACCC have identified that they can have an impact on in the market will not materially affect farmers like you. That is a concern for me.

Mr RYAN: It is a big concern for me too.

The ACTING CHAIR: Can you explain the size of your operation without going into too much detail and breaching any commercial in confidence? What is the size of your herd?

Mr RYAN: I am milking 200 cows at the moment. I was projecting to milk 250 to 300 cows this year in a new dairy. My existing dairy is too inefficient to milk many more cows than I am currently milking.

The ACTING CHAIR: How old is your existing dairy?

Mr RYAN: The front half of it is 60 years old; the back half of it is 25 years old. I have got assets somewhere in the region of $4 million involved in the business and I have got debts somewhere in the region of $2 million.

The ACTING CHAIR: The current milk price that you are getting makes it difficult to make investments in your assets for enhancements and improvements?

Mr RYAN: I cannot justify borrowing another $400,000 to build a dairy that would allow me to grow further. My plans this year involved growth and involved that investment. If it had rained well through autumn and winter I would have probably been in a good position to do that. But it did not rain and I was forced to supplementary feed nearly all year, instead of for the three months of the year when I would normally plan to do some supplementary feeding. It would normally be for an occasional period of cold weather in winter and for most of summer. I have silage reserves to facilitate that and I had more silage put away as a drought reserve, which I have obviously used. That has insulated me from buying much hay. I have only had to buy two loads of hay this year to feed the dairy cows but my grain price has been smashing me.

The ACTING CHAIR: Where did you source that from? Was it local?

Mr RYAN: No, I was sourcing hay from Hopetoun in Victoria, which is a journey of approximately 900 kilometres, and from Henty, which is 450 kilometres away. And I could only do that after the new season of hay was harvested.

The ACTING CHAIR: I am keen to hear your views on why you think a milk commissioner or farmer advocate would be worthwhile and, more importantly, what they would do?

Mr RYAN: They would publicise New South Wales farms' cost of production, which is probably more readily accessible through dairy farm monitor projects than it is through ABARES, with respect to the ACCC. They would report publicly on the industry's cost of production and the farmgate milk price and would keep that in the public eye. They would have some oversight of supermarket processes and the processes around farmer interactions from an independent point of view. They could report on the efficiencies and effectiveness of changes that are being proposed with the code of conduct and other things that are being proposed to improve the industry. There is some oversight required for those changes as they get rolled out. Indeed, things need to be done over and above the code of conduct.

There needs to be an overall increase in the retail pricing of dairy products, and that needs to flow through to the farm gate. One thing I do agree with the ACCC on is that there is nothing that mandates that an increase in retail price must flow through the processor to the farmer. We need all of those steps to work for farmers to get more money and farmers need more money. Quite over and above the drought that is crippling so many farms, our good years recently have not been good enough to allow us to put a cash reserve away to allow us to fund our way through this drought. We all know that droughts will come.

The ACTING CHAIR: So you were not able to develop the resilience?

Mr RYAN: I was operating on an overdraft before the drought started. I should have a clear overdraft. Ideally, I should have a farm management deposit account, which is the financial vehicle that the Government has designed for farmers to use to put money away in during good times and to draw on in bad times. We do not have, as dairy farmers, that surplus in good times to put away to draw on so that we do not need charity and subsidies and these sorts of discussions,

The ACTING CHAIR: You are contracted to Bega?

Mr RYAN: Yes.

The ACTING CHAIR: Who picks up the milk from your operation?

Mr RYAN: It is a transport company subcontracted by Bega that I pay for.

The ACTING CHAIR: Is it a local company?

Mr RYAN: Yes.

The ACTING CHAIR: What is the make up of the 60-odd dairy farms in the Bega Valley? Are they family-run operations, are they corporates or is there new people coming into the sector?

Mr RYAN: They would almost all be family-run businesses.

The ACTING CHAIR: Generational?

Mr RYAN: Yes, predominantly. My family bought in. There are a few other young farmers who have bought in or leased farms. I would be one of the few new entries to buy a farm. When I say "I", my family invested in that farm. I took over in 2010. The other new entrants are leasing farms. Predominantly, they would be irrigated farms in the Bega Valley. I would be one of the few dry-land farms left.

The ACTING CHAIR: The other question I would like to put to you is related to input costs. We have heard a bit about input costs. During a drought, fodder clearly becomes expensive., particularly in a long drought. What other input costs are impacting on you? We all know about electricity. What else?

Mr RYAN: Wages. In a standard or normal year my largest input cost is wages, which has not included paying myself for the last three years. I have been living off the business repaying me small amounts of money I have invested in it over time. There is a lot of work that goes into it. There is also contracting. There is the grain that I would normally feed in the dairy to maximise efficiency and cow numbers and what have you to maximise my production per cow. In a normal year that is probably my second biggest cost after wages. There is fertiliser, seed for sowing crops and contractors.

The ACTING CHAIR: So your returns at the moment are looking pretty thin?

Mr RYAN: It does not matter how good the rest of the year is, this year, I will be making a loss.

The ACTING CHAIR: How much has aggregation been occurring in the last 10 years?

Mr RYAN: A lot of farms have been able to grow. I would suggest that the majority of farms in the Bega area have grown in the last decade. That was in large part facilitated by Bega Cheese listing as a public company and a lot of the existing farmers being able to trade on shares that they held in the cooperative. The long-term family farms would have had access to a reasonable cash injection if they were willing to sell their shares in the company. I personally have sold what few shares I had to invest in the farm. But the new entrants into the industry do not have that.

The ACTING CHAIR: That is true. Would you recommend for someone looking at investing in agriculture to go into dairy farming?

Mr RYAN: I could not in conscious recommend it as an investment. I love what I do and I work incredibly hard at what I do. I have a background in IT and banking and other things that would earn me an awful lot more money, but I do what I want to do. I may not be able to afford to continue to do so. As a financial exercise, it has cost me a small fortune.

The ACTING CHAIR: Earlier, you spoke about some of the things the State Government should do to either improve or ensure the sustainability of the dairy industry. In your submission you talked about a levy?

Mr RYAN: Increasing the price of dairy products is critical. A levy is a means of achieving that end. I accept that there is a lot of reluctance on the part of retailers to increase pricing and I accept that there is a reluctance on the part of government to step in and enforce that. But dairy farmers need it, and they need it quickly, and the only means of achieving it quickly, as I see it, is implementing some kind of levy.

The ACTING CHAIR: Where I was going with that is: It has been put to me, separate to this inquiry, that retailers have their retail price but on the ticket they should also say what the farmgate price was so that consumers are better informed about the pricing chain and what is happening along the way?

Mr RYAN: Yes.

The ACTING CHAIR: By the way, I do not have a view on that; I am just putting that up here to see what people have to say about it.

Mr RYAN: First off, it would be a very complicated thing to do.

The ACTING CHAIR: Absolutely, and that does not include the processors' costs either.

Mr RYAN: It is relatively straightforward on fresh milk. It is not too complicated with the likes of cheddar cheese because we can simplify it to a factor of 10 litres of milk to a kilo of cheese. It becomes a bit more complicated with some of the other products.

The ACTING CHAIR: Do you think consumers actually know or care about where their farm products come from in Australia, particularly in the big city here?

Mr RYAN: I think that there is a gap in their knowledge. I definitely think they care. They have demonstrated through various surveys, petitions and the like that there is certainly a care factor there. In particular, they want clean, green local produce, those sorts of things, which is an issue for all of the imported product that is appearing in our supermarkets, restaurants, fast food chains and the like.

The ACTING CHAIR: Thank you for making the effort to come here today. Thank you for taking the effort to put forward a written submission as well. You do not need to worry about how short it is; I assure you that you have hit a number of pressure points for the Committee, so thank you for your time. I do not think you took any questions on notice, so safe travelling back down to Bega.

Mr RYAN: Thank you very much to the Government as a whole and you in particular for hosting this inquiry because everything we can do to bring this to a greater level of attention at a community and at a regulatory level is really important, I appreciate the opportunity to be here.

The ACTING CHAIR: Thank you very much.

(The witness withdrew)

MARK KEBBELL, Executive Officer, Dairy Farmers Milk Co-operative, sworn and examined

JOHN BYWATER, Independent Director, Dairy Farmers Milk Co-operative, sworn and examined

The ACTING CHAIR: Welcome to the hearing looking at milk pricing. Would either or both of you like to make a brief opening statement?

Mr BYWATER: Yes, thank you. I will give just a little background. Dairy Farmers Milk Co-operative was formed prior to the sale of Dairy Farmers, the business, to National Foods in 2008. The idea of setting the cooperative up was to handle the milk supply going forward in an arrangement with National Foods, which then took over the Dairy Farmers brand. Personally, I have been in the industry for over 40 years and I was 12 years on the Dairy Farmers senior team before it was sold so I have a fair bit of background on one side of the fence and for the last seven years I have been on the board on the supply cooperative side, so I have seen the thing from both sides. That is a little bit of background.

We are pleased to come along to talk today and answer any questions you might have because we, as a milk cooperative, have a view, particularly on things like dollar milk. We had a number of appearances with the Australian Competition and Consumer Commission. We were a little disappointed in their view on things like one dollar milk because I think from commercial experience—and I am pretty sure that nothing has changed since I was in the senior group but it is one thing to look at a contract that might be between a processor and a retailer that says you will pay the competitive milk price; it is another thing for that processor to then circle back round to the retailer and say, "I want to put the price up". They are not the same thing.

We have seen the sorts of things that happened back in the day—and I am sure they happening now—that if you force that price through, there will be other ways that they will get square with you by reducing the facings you might have for your branded product, by deleting certain product lines, and that sort of thing. There was one stage back in the day where we elected in one region not to tender for the packaged milk contract and we were basically told, "Yes, you do have to tender" even though we did not want to. I think in recent times Lion, our partner, has recognised the difficulty in some of the regions because all of our milk goes to Lion Dairy & Drinks. They have been trying for some time, and eventually got agreement, to increase their price on their one, two and three litre milks but there is not a lot of recognition of that in the store itself. There was something, I think, in last week's Woolworths catalogue but there is nothing much in the store, so Lion, as a result, has suffered a decline in their sales because they put the price up.

All the money from the price rise is going to the farmers. The full 10¢ is distributed to the farmers. They have got an accounting firm, which is operating pro bono to ensure what happens. Our chairman is also on a little group that allocates the money, as is another farmer, who supplies Lion Dairy & Drinks directly. Our farmers are suffering substantially, and not only the ones who are directly impacted by drought; even our farmers in far North Queensland, as an example, are affected because once you have a drought in one area the price of fodder goes up everywhere, so while they can still grow some feed, they do need some inputs from grain and so on, and the price of that goes up for them as well, so it has a wide impact.

Finally, before I pass over to questions, Lion has had that thing going for a month and they have raised a million dollars. They have allocated that within each State—in Queensland, New South Wales and northern Victoria. That 10¢ translates to about 2.5¢ because not everyone has accepted the price rise. If you go onto a site that has been put up called truebluedrought, there is a list of all the retailers who are participating. Clearly by definition those who are not on there are not participating. Not all milk goes into white milk of course; some goes into flavoured milk, some goes into yoghurt, things like that, but mostly it is into white milk. With those comments, Chair, I will open this up for questions.

The ACTING CHAIR: Mr Kebbell, do you have anything to add?

Mr KEBBELL: Not to that. I am happy to answer questions of course because our primary piece was on collective bargaining.

The ACTING CHAIR: Yes, and Mr Bywater, was that a prepared statement that you read from?

Mr BYWATER: No.

The ACTING CHAIR: Or did you just wing it?

Mr BYWATER: I just winged it. Chair, if I just might just add one thing. On the collective bargaining theme, one thing I wanted to say is going through a mandatory code or looking at setting up a mandatory code,

The ACTING CHAIR: Yes.

Mr BYWATER: You are probably aware that a lot of hearings are being held about that. If I could just put one shot into something that the New South Wales Government could do in assisting farmers, is that we are very lucky, we have a fair lump of cash behind us from the sale of the business and Dairy Farmers Milk Co-operative is a part shareholder. We have got some money and in our milk supply agreement with Lion we are sort of like a collective bargaining group. We have this sort of independent expert, like a dispute resolution process. We are well resourced. We have had a few battles going back in time with Lion. We do not these days because everyone now realises that if you are both well resourced, you have to be sensible.

But there may be other groups that are not well resourced, and while the mandatory code talks about a cost effective dispute resolution process, it is very hard for farmers to get data together without it costing them a lot of money. There needs to be maybe a pool of funds for genuine groups of farmers who have a dispute, some funding that will help them. We are aware the Tasmanian Government did this a number of years ago when some Tasmanian farmers were in dispute with Lion at the time.

The ACTING CHAIR: To clarify, they set aside a fund that could be drawn down on if there was a dispute?

Mr BYWATER: They were granted some money to help them in their dispute. It was not a big amount of money, it was $38,000, but in terms of these sort of things. We had Walter Sofronoff—whom you may know from the recent Wagner's thing up in Queensland, they are not cheap—as our dispute resolver. I think it would be great to have a pool of money for genuine cases, you do not want to be dealing with one-on-one fights, sort of thing, but if there is a genuine case there should be a pool of money there.

The ACTING CHAIR: One of the proposals tested in this forum has been the concept of a milk commissioner. There are a range of views about what that would look like and what the functions of that entity would be. Dispute resolution or issues around abrasive points in contracts is one area that maybe they could deal with. Do you have a view about that?

Mr BYWATER: There has to be a mechanism. Collective bargaining type arrangements work when you have got good resourcing, you have got somebody who can solve those problems that do occur from time to time. I think that sounds like a pretty good idea.

The Hon. WES FANG: The ACCC gave evidence earlier and they were talking about the code of conduct, they were proposing an industry code for processors. You only deal with one processor and you have exclusive arrangements with them. You would not necessarily be looking to change processors because of your agreements?

Mr BYWATER: Our current agreement runs out in 2019 and we are almost finished signing a new agreement. We are much smaller now. We were a billion litres back then, but as Lion lost a number of those supermarket contracts we have become smaller. So the amount of money we will get is a fair bit smaller than that. Our new agreement is not an exclusive agreement. We have an amount of milk we have to supply to Lion in the various regions, but apart from that we can do what we want.

The Hon. WES FANG: The point I was getting to was you are happy with signing an agreement to provide that. Other than the ACCC wanting people to have the ability to switch processors, do you see anything that the ACCC was looking to implement from their report that would have a market difference on the farmgate return to your producers?

Mr BYWATER: I think from what I saw from the ACCC was if a processor did not want all of someone's milk they should not be able to restrict them to still supply that to that processor. I think that in itself is sensible enough. If you are someone like Lion Dairy & Drinks you do not want to be unsure how much milk you are going to pick up any particular day because somebody has already picked it up and taken it away. If Lion wants all the milk and they are prepared to pay for all the milk at the right price I think an exclusive arrangement is fair enough. If they do not want all of the milk—and this was one of the disputes we had back in the day because we had more milk than they needed and there was not a mechanism where they could pay a different price. If they do not need the milk, then there should be some mechanism where people can supply it elsewhere.

Mr KEBBELL: Yes.

The Hon. SCOT MacDONALD: You have just made some comments about sales have gone off when the price went up, and the Committee has heard other witnesses talk about the price elasticity. Is that white milk you are talking about?

Mr BYWATER: White milk. What has happened is that Lion Dairy & Drinks has put its price up on one, two and three-litre white milk, whereas the major retailers have only put it up on the three-litre bottles. I went and had a look this morning to make sure that is correct, and it is only on the three-litre bottles, and there is signage that reflects that so they are not fooling us. It means the two-litre milk is still $2, whereas the Lion milk, which was originally $2.99 is now $3.19.

The Hon. SCOT MacDONALD: Are we starting to get evidence about pushback from the consumer?

Mr BYWATER: I do not think the consumer necessarily understands what is happening. Initially, the News Limited papers ran some pro bono advertisements for Lion Dairy & Drinks because Lion is not getting any money out of this at all and it is actually costing them money to do it.

The Hon. SCOT MacDONALD: Just administratively?

Mr BYWATER: Administratively and so on.

Mr KEBBELL: And the loss of sales, of course.

Mr BYWATER: The accounting firm is doing if for nothing.

The Hon. SCOT MacDONALD: Where did they substitute to?

Mr KEBBELL: They are going to the generic brands, it seems.

Mr BYWATER: It is still $2. The $3 milk has gone to $3.30, but that is all.

The Hon. SCOT MacDONALD: And they go back to the $2 milk.

Mr KEBBELL: But the other branded milks have not necessarily changed either. So Lion's—they have been precluded somewhat in point of sale, and that has been explicit from the supermarkets.

The Hon. SCOT MacDONALD: What I am getting to is, we have had witnesses earlier in the week and now today saying $1 milk is a killer, why can we not go up to $1.10 or $1.20, or whatever it might be. I am tying to understand, is the price elasticity there very low, or not?

Mr BYWATER: I think people think they are doing the right thing by buying the supermarket brand, because there has been enough publicity on their behalf to suggest that they are doing the right thing. The fact that it is quite limited in their range—

The Hon. SCOT MacDONALD: And short term possibly, this might finish.

Mr KEBBELL: And short term. The story, if you like, the narrative on the Lion branded milks, Dairy Farmers and Pura, is arguably not well-known, and they are now—

The Hon. SCOT MacDONALD: Consumers are fickle.

Mr KEBBELL: They think they are doing the right thing.

Mr BYWATER: What tends to happen, and it happened after deregulation, is they will do the right thing for a period of time and then they forget. They have to be reminded, and it costs money to remind them. You are not making any margin on white milk. It is pretty hard to keep reminding people to buy it. If you are losing money on it—

The Hon. SCOT MacDONALD: Putting aside the short term measures, the drought levies and whatever you want to call them, if the $1 milk turned into $1.20 milk would that in your view affect overall national sales?

Mr BYWATER: As long as everyone was charging that, no, I do not think it would.

The Hon. SCOT MacDONALD: That is low price elasticity?

Mr BYWATER: Yes, low price elasticity.

Mr KEBBELL: There has been a conditioning.

Mr BYWATER: There is differential pricing.

The Hon. SCOT MacDONALD: Do we have a role in government, this Committee, to get people from $1 to $1.20, not that we can pull a lever with the supermarkets but if there is enough leadership, whether it be from government, industry or media, whoever it might be, to say $1 is not sustainable, we have to move to $1.20, we cannot force you to but you need to. Is that tenable or feasible?

Mr KEBBELL: One of the difficulties is that the economics of it is very different in each State. The milk price and the size of the State and the size of the regional towns in Victoria—we are not inside the Lion businesses and others—is arguably profitable for all entities. By the time you get to here and Queensland, where the geography is much further—

The Hon. SCOT MacDONALD: It is a higher cost

Mr KEBBELL: Much higher cost, higher input costs, the higher costs of milk that they are paying at the farm gate, the higher costs of distribution just make it untenable. They have lost both volume of sales to the generic brands at $1 a litre and margin. They can no longer charge the premium they were for branded milk.

The Hon. SCOT MacDONALD: I will be the devil's advocate. I am a mean economic rationalist and I say that if that is the way it is going to be then that is the way it is going to be. Our milk will be produced in those low cost of production regions of Victoria and the southern region generally. At the end of the day, it will be processed there by and large and shipped everywhere from Illawarra to North Queensland. That is what the economics determine.

Mr KEBBELL: When I said its works economically in Victoria, that related to milk produced, distributed and consumed in Victoria. There is a rough rule of thumb that Mr Bywater has talked about for years, and that is 1¢ a litre per hour on the road or 100 kilometres. That is an effective and reasonably accurate measure of the new cost of the milk as it comes up and down the country.

Mr BYWATER: The supermarkets have every right under our law to charge and $1 in Bourke, Broome and Mount Isa, and they do. I am sorry to use Queensland rather than New South Wales, but it is a good example because it is not near a cheaper milk pool. The milk supply in south-east Queensland is shrinking, but the last thing that happened to the price was when Parmalat put it down. If you are a hard-nosed economist, you would say that if something is in short supply the price should go up, but it does not.

The Hon. SCOT MacDONALD: Clearly it has not; clearly there was enough supply.

Mr KEBBELL: Milk has been brought in, but it must be brought further and further.

The Hon. SCOT MacDONALD: Will the market not determine that at the end of the day?

Mr BYWATER: Milk is relatively cheap in Victoria at the moment. It is about 40¢, 42¢ or 44¢ a litre; something in that order.

The Hon. WES FANG: Is that the farmgate price?

Mr BYWATER: Yes, but that is because skim milk power is $1,900 a tonne when it is routinely $2,500 and the price of cheese is down. Butter is the only thing that is more expensive than it was, and it has come back in price. The milk price in Victoria will be 50¢ or 60¢ a litre. Hopefully that is not far away. It probably will not be in the next 12 months, but it will happen. I assure you it has happened many times.

The Hon. SCOT MacDONALD: That is a realignment of supply and demand.

Mr BYWATER: Yes.

Mr KEBBELL: On the global market.

Mr BYWATER: We live in a distorted market. About 7 per cent of the world's milk is traded. New Zealand has a big share of that, as do the European Union and the United States. Therefore, a small movement in those markets makes a big change in the milk that is available to be traded around the world. However, a lot of our pricing is driven off that and we get great swings up and down. It is very hard to predict where the price will rise and fall. Members might be surprised that if you take into account milk imported to Australia in the form fancy butters, like Lurpak and Irish Kerrygold, or pizza cheese that is sold here for $6 a kilogram, and if you equalise it, we do not have an international surplus in Australia and pricing would be somewhat different.

The ACTING CHAIR: I would like to explore the collective bargaining group concept. I take it from your submission that it is not prevalent in the dairy industry. Why?

Mr BYWATER: Largely because processors have not had to deal with them. In fact, some processors have actively said that they do not want to deal with groups of farmers. It may be because it might give the farmers more power and processors may not want that. We are also fortunate in having money to operate and we have resources if we need to have a fight with our processor, Lion. I hasten to add that we have not done so for some time. However, other people have not had those resources. The farmers ended up with 20 per cent of the shares in the Dairy Farmers Cooperative. They had effectively $200 million, and they gave about $180 million of that back to the farmers, plus what the farmers got themselves as owners of the business. No-one else is in that position. Many have been authorised and a few smaller groups have worked quite well. Woolworths has taken on some of them to create the impression of looking after farmers.

Mr KEBBELL: There is Farmers' Own.

Mr BYWATER: Yes, but in the main that is not what happens. Probably half a dozen groups have been successful, but that is about it.

The ACTING CHAIR: If you set up a group, you have to agree on a set of principles at the outset about how it will operate.

The Hon. SCOT MacDONALD: And you have to get authorisation.

Mr BYWATER: And then you go to the ACCC and say what you want to do. It is not difficult; the ACCC does not make it difficult. The problem is that the processor may not want to deal with them. Apparently a group was set up almost as a Facebook group and it attracted a big volume of milk. It wanted to go to Saputo with 200 million litres of milk. When it came time for Saputo to deal with them, it said it did not want to do that. It wanted to treat all the farmers the same; it did not want to treat one group differently.

The ACTING CHAIR: Are there standardised contracts?

Mr KEBBELL: Our contracts are all the same for all members.

Mr BYWATER: Within a region. Within what we call "Central New South Wales", which is from south-east Queensland as far as logic goes, and the Riverina is in "North Victoria". The contracts everywhere in between are the same and there is one system and our milk quality requirements are the same everywhere.

The ACTING CHAIR: I can see advantages in collective bargain groups, particularly with a sector where people work extraordinary hours and would struggle to find the time to work through contracts, not just with processors but also for electricity and so on. I can see the benefit in keeping combined intellectual capacity in a collective bargaining group. It is almost a divide-and-conquer approach. I am being cynical, but is that the issue?

Mr KEBBELL: That is what we try to avoid as a collective bargaining group; we do not want them splitting off.

Mr BYWATER: The difficulty was getting the resources. They have to have someone who is driven to put it together. If it is just a lot of people wishing it would happen, it would not happen. There is a group around Taree that supplies Woolworths here and it has had that person who has been willing to put it together and work on it. It has done a good job.

Mr KEBBELL: Arguably they work in partnership as well. It is not just about the fight; it is about understanding the partner.

Mr BYWATER: That is true.

Mr KEBBELL: While the Woolworths Farmers' Own group is working together in a collective arrangement, they are working with their partner—that is, Woolworths—to sell the product well and to have a supply chain that works. If you are only militant, that is when a retailer or a processor does not want to talk to you.

The Hon. SCOT MacDONALD: There is some goodwill.

Mr KEBBELL: There has to be some goodwill, which is what we have. Our model works and it is a good story. The high-level milk supply agreement is the overarching framework that has a number of key pieces that make it work. I suppose it is a success story we would like to have out there. There is nothing for us in that, but we do not lose in sharing it. We are like all primary producers; we are willing to share. With the dispute resolution mechanism, both parties start well in the centre. There are no ambit claims, particularly about cheap milk from the processor or expensive milk from our side, because we know that an independent dispute resolution expert will dismiss either party. As a result, we start sensibly in the middle and negotiate. The transparency of farmgate prices between processors and their suppliers is an issue.

Mr BYWATER: Five or six years ago, probably six years ago when we had our first dispute with what was National Foods then, it was about the view of the competitive prices. Our milk supply agreement says that National Foods or Lion Dairy & Drinks have to pay the competitive price in the region. Then you have to worry about what is the competitive price in the region. They would come in and say, "These are three example farms and this is what we think and therefore the price is competitive", and we knew it was not. So what we actually did was we sat down and modelled all of our farms to work out what the actual cost of milk to Lion was, or to National Foods, and what the cost would be if they supplied Parmalat under the same scenario, or if they supplied Norco or whatever.

We were able to demonstrate and convince the independent expert, Walter Sofronoff, that what we were saying was correct: that the price was not actually competitive; it was below competitive. Therefore, we ended up with him directing what should happen in certain areas. Without that resource that we had to do that, if you are just a small group of farmers, you may not have the resources to build a big model—a forensic model, effectively—with everyone in the membership. If it is a small group may be you can do it, but if it is a bigger group, there will be great difficulty. The resourcing is critical to the success of that.

The ACTING CHAIR: You may want to write down the spelling of the name of Walter Sofronoff. It would help Hansard, if you happen to know it.

Mr BYWATER: Yes, I think I can remember it. He was a Solicitor-General of Queensland at some stage.

Mr KEBBELL: I will finish that point, if I could. Invariably those contracts are confidential. So, the means that we have to go to, to get that information involves someone breaching something along the way for the informal sharing from other suppliers. So the ACCC was quite strong on the transparency because the only reason the processor want to suppress that information is to keep prices down. The openness is a key issue that the ACCC fought for and recommended and we are big supporters of.

The Hon. MARK PEARSON: Have you looked at other products as to why this has not happened in other industries to such an extent, such as beef, pork or lamb industries? Why have not retailers been as ruthless with them as the dairy industry?

Mr KEBBELL: Have they commoditised milk? Lamb just about sits beside lobster now, does it not? When other primary products' supply shortens, price rises. It is the staple milk thing that the supermarkets have created.

Mr BYWATER: I think if you look back into history of what was related, the things that are regulated were milk and bread. If you go into the supermarkets now, I think you will find that bread suffers the same pain to whoever is putting that together as milk does. The other thing is, I think there is a view against retailers that there is always some cheaper milk from somewhere else, whereas I do not know that is necessarily always the case in beef. If you have a drought long enough, you just do not have the animals there. You do have some in the very short term as people have to reduce their herds, but in the longer run supply and demand does come into effect, whereas there is a view in retail, "Well, there is still plenty of milk down south". I do not know if you are aware but the milk volume in Australia has dropped again.

There is going to be an "eight" in front of the billion litres, whereas, if we go back, it was almost 12 around the time of deregulation. There are a number of reasons why that has happened; it is not just deregulation. Deregulation has driven some of that. I think the Victorians forgot that they were getting some money out of the regulated system, not only in liquid milk but also through a market support program, but also the processors down there forced their farmers to produce flat milk when they actually should have left in producing milk on quite a seasonal basis, like they do in New Zealand.

The Hon. MARK PEARSON: I put to the ACCC about their terms of reference or one of the areas in which they would prosecute and apply the question. One of the main instruments they use is misleading and deceptive conduct. I put to them as to whether it should be broadened to include unfair and improper conduct. That could be a question or a measure applied to a lot of processes, which they identify as being probably the main problem in this issue, in terms of whether the price goes up or not at the retailers. It is usually as a consequence of the retailer or the processor wanting that. If it does go up, it does not necessarily go back to the producer. Do you think if that was part of their instrument of prosecution or investigation, that would assist dealing with this issue?

Mr KEBBELL: It has been suggested to me that the Food and Grocery Code has some of those powers but none of the processors are willing—

The Hon. MARK PEARSON: It is a code, though, as opposed to an Act.

Mr KEBBELL: Right. I am not quite sure of the impacts, but it has also been suggested to me by processors that no-one is going to be the first one to put their hand up and take them on because probably the consequence is fatal to the business. It is so commercially—Their share of the dairy markets of white milk is huge. We used to drop into the convenience store or the petrol station on the way home, but the supermarkets' share of that market now is extraordinary and they are just not willing to put their hand up and say they are up to something no good because they need them so much.

The Hon. MARK PEARSON: But the ACCC might think—

Mr KEBBELL: They need a complainant, do not they? Or do they not, I am not quite sure.

The Hon. MARK PEARSON: No, they do not.

Mr KEBBELL: That is a good point.

Mr BYWATER: I would like to correct something. I think it is unreasonable on the processors to say that they are the problem in this. I do not think it—

The Hon. MARK PEARSON: I do not think that is a given, or that it is 100 per cent the case.

Mr BYWATER: I think you will find that certainly in the areas of white milk, the major processors—Parmalat and Lion—are losing money on white milk. In Victoria they may not be at the moment, as I said, while the price is where it is, but in time they will be. There are losing money because if you are someone like Lion, you are used to sell it—When my son started in a coffee shop out here at Parramatta, they used to get the delivery from the dairy farmers. He used to work at Muffin Break in Westfield, and he used to get the delivery from the dairy farmer's truck. Now those sorts of shops take the shopping trolley up to Woolworths—

The Hon. SCOT MacDONALD: And buy the dollar milk.

Mr BYWATER: —and fill it up with the dollar milk. That is what happens.

Mr KEBBELL: They might have the facings in their fridge with dairy farmers just so that they can—Because there will be a deal with them.

Mr BYWATER: They reduced the amount of milk that goes through what we would call the wrap tray. Their volume is falling and their margin is now lower. They would have charged $3.49 a few years ago for two litres of milk, now it is $3.19 with the drought, but it was $2.99. They are making less money and they are selling less of it. Lion, as you may know, has got the business up for sale. Personally, I think they might have trouble finding someone who wants to pick up. Probably, two-thirds of their volume is going into white milk and they are losing money. They are making good money out of flavoured milk and they are making money out of dairy foods and out of fancy cheeses, which are not produced here, but they are struggling in the other areas.

The ACTING CHAIR: Gentlemen, thank you very much for making the effort to come here today. Thank you very much for providing a written submission. I do not think that you took any questions on notice, so I do not have to do the rest of the spiel because you do not have to worry about that. Thank you very much and travel safe.

Mr BYWATER: Thank you.

Mr KEBBELL: Thank you.

(The witnesses withdrew)

The Committee adjourned at 15:23