2ND EDITION

Material consolidated, including supplementary papers 1 & 2

The Dairy Industry Crisis

The Case for Government Intervention

Farmers face unconscionable & un-Australian behaviour arising from the structure of the dairy industry.

No spin – just evidence. A Solution at Last

In the national interest, help dairy farmers become profitable and put the sector on a growth path

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Executive Summary

The analysis on the dairy industry outlines the huge power imbalance between the Retailers and Processors, and the Processor and the Farmer. It is as much about structure as it is about behaviour.

The ACCC power to intervene and achieve fair pricing for the consumer is very limited. Competition Law will not work. The market has failed and no Code of Conduct or Government jawboning will work. With drinkable milk, the problem can only be solved by price regulation.

The market has failed and market intervention is required.

Adam Smith, the father of capitalism and the free market would support market intervention and the reasons for it.

The Retail Oligopoly is doing very well with profitability and return and are capturing an unfair amount of the rent.

The retailers, through price regulation, should increase the retail price of milk by $0.40 cents per litre to $1.70. This should go straight to the farmer without deduction by the Processor. For the Farmer, it does not matter what the retail price is, the farmer requires a lift of $0.40. The Retailers should be precluded from extracting any of that price increase out of the Processor. A recent repeat of the situation with Coles and Lactalis should be avoided.

An increase of $0.40 to the retail price of milk will only give farmers a 13.3c increase on the average litre price at the farm gate from about $0.48 to $0.61 representing an increase of 27.7%. Whilst this is attractive, we must recognise that dairy farmers have been disadvantaged for years. They now have drought and bush fires. They do not receive government subsidies as most overseas countries do. This increase will attract more dairy farmers, grow the sector and improve exports.

With the current state of the dairy industry, the consumer will accept a price increase, certainly 40c taking the price to $1.70 provided the Retailer and Processor do not benefit.

Electricity and the dairy industry are compared.

Deregulation in 2000 has failed.

Regulation is needed because competition between retailers is such that they will not increase the price unless it is industry wide. Milk is an important part of retail brand and pricing strategy and individual supermarket volume will fall if the milk price is not neutralised between competitors.

The pre-2000 situation should be restored and the dairy farmers should be entitled to join together with the approval of the ACCC to negotiate with the Processors price and terms.

With a possible takeover of the Lion dairy there should be conditions on Mengniu given the reality of the dairy market in Australia.

By reviewing the structure and strategy of the New Zealand (NZ) and Indian dairy industry, you can see why they have been so successful and how disadvantaged Australian dairy farmers are**. India and NZ prove that corporatisation has been disastrous.**

With the profound change in the dairy sector since de-regulation mid-2000 the public do not understand how significant this change is and the need to take immediate action, but also medium to long term plans to reshape the industry. My focus is on the now like the next few weeks. With the bushfire crisis, the rate of failure is increasing beyond 2 to 3 a week. Rabobank's 2019 pre-Christmas forecast of a 5.8% to 8.3% decline in available milk is now substantially underestimated as fire effected farms are added to the list and many cannot produce or may never return to production. Action is required within weeks <u>not</u> months.

A recent report by John Brumby compliments this report. There are no inconsistencies. The Australian Dairy Farmers Limited (ADF) (December 2019) submission to the Senate Economics Reference Committee is also substantially complementary but there are some important points of difference. The ADF material is nevertheless very helpful.

Note: For the purpose of this paper, 'drinkable milk' encompasses all milk (fresh and UHT), branded or unbranded, flavoured or otherwise in any packaging. Milk solids includes butter, cheese, yoghurt, cream, milk powder and similar products are not included in the definition of drinkable milk.

Why Milk is so Important

Where Would We Be Without Milk and Milk Pricing?

Australia's dairy industry is currently facing a serious structural problem. If the situation is not addressed by timely and prudent market intervention, the sector will collapse leaving a fragmented cottage industry. Dairy farmers are selling and the industry will lack scale.

The cattle, sheep, crops, fresh fish, and meat supply chain are much easier to manage. These products do not require immediate processing or consumption. Milk production requires considerable investment in processing facilities, far more than with other agricultural products.

Fresh milk and dairy products are critically important for the health and well-being of Australians. The Chinese consumer is paying extraordinarily high prices for Australian baby formula milk.

Milk has been a fundamental part of our diet for the thousands of years and is like mother's milk. Fat and protein are critical to our wellbeing (See Appendix 1). There is small segment of plant-based milk for vegan and lactose intolerant with price tag of at least $3 a litre.

Australian milk one litre carton at $1.29 is by far the world's cheapest milk. You can currently purchase one litre, regular milk in Australia for approximately $1.20. In comparison the equivalent milk price in Canada is $2.58 and $4.28 in Hong Kong. The average world retail milk price is $1.70 and in the developed world is $2.40. In NZ, milk is $2.51 a litre; an extraordinary difference.

It is curious that whilst Australian drinking milk prices remain flat but they still produce good profits for the retailer. In the year 2000, when the dairy industry was deregulated, the Australian milk price, pre-inflation was $1.37 (ABS). The price of milk has fallen since deregulation but other dairy products like butter, cheese and yoghurt has increased considerably. Table 1 outlines the prices of milk, butter and cheese in the year 2000 and 2020 sourced from Australian bureau of Statistics and present prices.

Table 1: Main Dairy Products Prices in 2000 and 2020

March 2000			March 2019	January 2020
Australian Bureau of Statistics (ABS) Prices				
Milk	1 Litre	$1.37	$1.00	$1.20
Cheese	500 Gram	$3.56	$4.50	$7.50
Butter	500 Gram	$2.00	$3.50	$5.20

The price difference between milk on one hand, wine, beer, bottled water and soft drinks on the other hand in Australia and prominent cities of the world is shown in Table 2. Australians are paying very little for milk compared to overseas and with other drinking products. Milk requires considerable processing and handling, much more than soft drinks.

Note in Table 2, the average price in the world for milk is $1.70, wine $13.55, beer $4.90, bottled water $1.50 and soft drink $1.90. How can you possible justify a minimum price of less than $1.70 for milk? It is ridiculous and an insult to our dairy farmers and the inherent food value of milk as a key factor with our health. So we should be encouraging the consumption of Australian milk for health and general well-being. Appendix 2 sets out a typical dairy plant process.

Note the difference between the world average of $1.70 and the average of the developed world being $2.40. This is a very significant difference and close to NZ at $2.50 and so more relevant to Australia.

Table 2: Snapshot of Global Prices of Milk and other Drinks

Comparative Global Prices (Developed Countries) per litre									
Milk		Wine		Beer		Bottled Water		Coke /Pepsi (0.33 litre bottle)	
Australia	$1.20	Australia	$15.00	Australia	$8.00	Australia	$2.50	Australia	$3.28
UK	$1.70	NZ	$14.03	Canada	$6.62	Japan	$1.40	Hong Kong	$1.73
Sweden	$1.71	China	$15.62	UK	$6.76	Singapore	$1.40	Japan	$1.83
Italy	$1.80	Japan	$16.07	NZ	$8.00	Denmark	$1.67	Singapore	$2.16
Denmark	$1.83	Canada	$16.55	Ireland	$8.05	HK	$1.70	Canada	$2.37
UAE	$2.26	USA	$17.53	HK	$9.33	UK	$1.74	UK	$2.39
Malaysia	$2.32	Malaysia	$21.12	France	$9.60	Canada	$1.85	Sweden	$3.01
Switzerland	$2.33	HK	$22.38	Denmark	$9.69	NZ	$2.15	NZ	$3.03
Japan	$2.48	Norway	$23.91	Sweden	$9.78	Sweden	$2.20	Denmark	$4.76
NZ	$2.51	Thailand	$28.94	Singapore	$10.73	Norway	$5.42	Norway	$4.89
Thailand	$2.54	Singapore	$32.18	Norway	$14.19			Switzerland	$5.88
Canada	$2.58								
China	$2.75								
Norway	$2.89								
Singapore	$3.20								
HK	$4.28								
Average	$2.40	Average	$20.30	Average	$9.16	Average	$2.20	Average	$3.21
Average of Global Prices									
	$1.70		$13.55		$4.90		$1.35		$1.90

In years 1999 to 2010, the price of regular milk was above $1.40 a litre as compared to today's price of a litre of carton of unbranded milk at $1.29 a litre. The current average price is temporary. Coles price at one stage was $1.00 a litre. The prices of milk and butter in year 1980, 1999 and 2010 were 1.5 and 2 times the price of milk. Today the price of butter is 5 times the price of milk.

Table 3: The price of butter has increased much more than milk

Source: The Australian Bureau of Statistics (ABS)											
Year		1901	1911	1940	1950	1960	1970	1980	1990	1999	2010
Milk	0.95 Litre	$0.03	$0.04	$0.06	$0.09	$0.15	$0.19	$0.63	$0.85	$1.40	$1.36
Butter	454 Gram	$0.13	$0.15	$0.19	$0.22	$0.48	$0.53	$1.00	$2.09	$2.09	$2.78
Butter Times exp		4.33	3.75	3.17	2.44	3.20	2.79	1.59	2.46	1.49	2.04

A supermarket price comparison for dairy product in Table 4 shows how close Coles and Woolworths are in price, with Aldi being lower.

Table 4: Current Dairy Item Prices

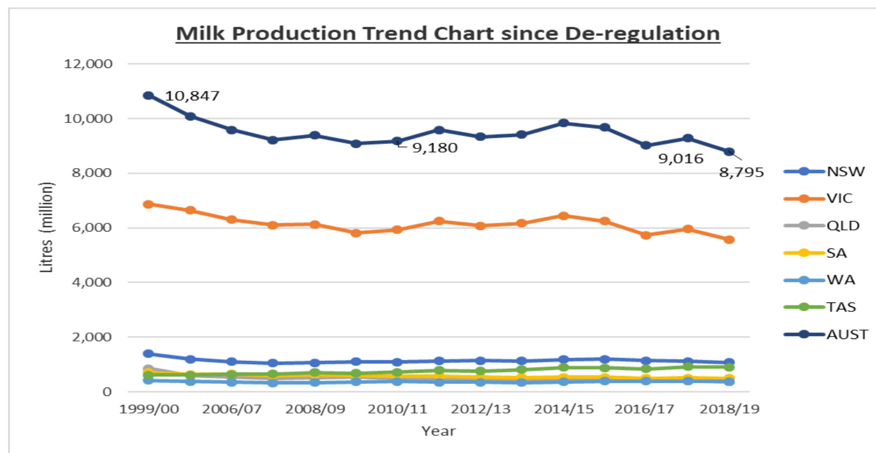
Survey 16 November 2019

ALDI				COLES				WOOLWORTH			
Cheese	Brand	Gram			Brand	Gram			Brand	Gram	
Slice light	Cowbelle	500	$3.69	Slice	Coon	250	$6.00	Kraft Slice	Kraft	432	$7.50
Natural Slice	Westacre	500	$5.99	Slice	Coon	500	$8.60	Slice	Coon	500	$8.60
Block Cheese	Westacre	500	$5.99	Block	Bega	500	$10.20	Bega Block	Bega	750	$12.50
Block Cheese light	Westacre	500	$4.99								
Butter											
Butter	Butterfully	250	$2.79								
Butter	Butterfully	500	$4.99	Butter	Coles	500	$5.60	Butter	Woolworth	500	$5
								Butter	Devondale	250	$4.30
								Butter	Western Star	250	$4
Yogurt	Dairy Dream	850	$3.99	Yogurt	Activia	700	$5.00	Yogurt	Jalna	1000	$7.50

In 2018-19, of total milk production, drinkable milk was 28%, the remainder went to cheese, butter, milk powder, yoghurt, cream and other dairy related products. ‘Drinkable milk’ encompasses all milk (fresh and UHT), branded or unbranded, flavoured or otherwise in any packaging. Milk solids includes butter, cheese, yoghurt, cream, milk powder and similar products.

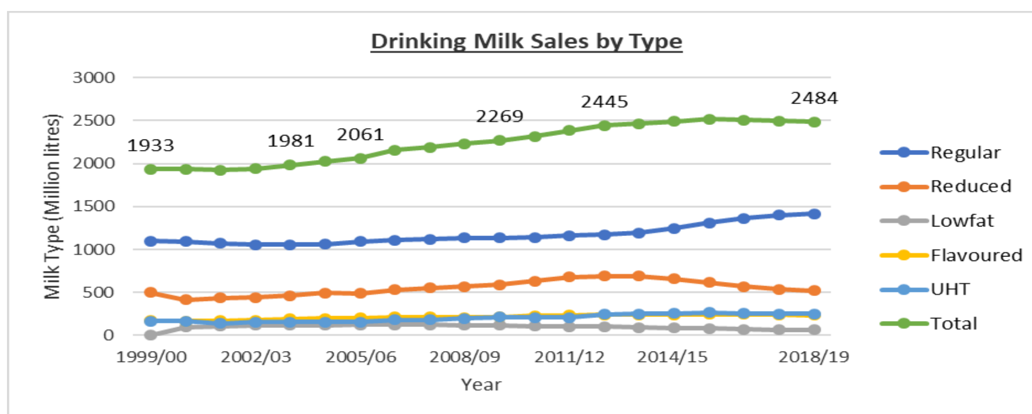
The Australian milk production has been progressively declining since deregulation. In Table 5, milk production has declined from 10,847 million liters in 2000 to 8,795 in 2018, a decline of 19%. This continued to decline in 2019 and with the drought and recent fires, dairy farmers are quitting in significant numbers and numbers will drop significantly further. Processors are now finding it difficult to source enough milk.

Table 5: Trend of Milk Production since De-regulation



(Source: Dairy Australia)

Table 6: Drinking Milk Sales by Type



(Source: Dairy Australia)

As in Table 1, in year 2000, one litre of milk was sold at $1.37, 500 grams of cheese was $3.56 and 500 grams of butter was $2.00.

On average one litre of milk was sold for $1 till March 2019. At present due to draught levy one litre regular milk pack is sold for $1.29, 2 litre regular milk pack for $2.39 and 3 litre regular pack for $3.59. On average say that one litre of regular milk is sold for $1.20. Most are also available in two or three litre containers where the gross profit dollars will be much more (refer section on Supermarket Economics). In 2018 per capita milk consumption was 102.9 litres. It dropped to 98.6 litres in 2019 and is continuing to decline.

The average number of people per Australian household (ABS) is 2.6 and milk per capita consumption is around 99 litres. With a 40-cent increase on farm gate price, the average household will pay only $102.96 per annum or $2 per week. **The average consumer will unquestionably accept this for our struggling farmers.** This is the Australian way.

Dairy Australia forecasts the Australian farm gate milk price will fall in real time until 2023/24 so it is proposed farms will be in a worse situation. ACCC analysed the impact of $1 per litre private label milk on earnings through the dairy supply chain, as in Table 7.

Table 7: Where Does the Money Go?

85% of Australian milk production comes from Victoria and its adjoining regions, so their supply chain cost is more representative. Out of $1, the one litre regular milk, approximately:

- 45 cents go to the Farmer,
- 37 cents to the Processor and
- 18 cents to the Retailer.

After the recent temporary, increase of 20 cents per litre, where milk is on average $1.20 per litre, this drought levy of 20c is on average broken down to:

- 10c for the Farmers,
- 4c for the Processors and
- 6c for the Retailers.

Despite this increase, many farmers are still unprofitable. The extra 10 cents are temporary and it is not known when it will finish. Discussed later is how Coles dealt with this 10c to the Norco farmer. Farmers are the least powerful players in the "value supply chain" that runs from cows to customers via Processors and supermarkets. Farmers are paid for their milk as a 'solid', not as a liquid by the Processor.

For example, the opening price on July 1st 2019 for Bega suppliers was $ 6.75. This is based on the gross price of $2.55 per kg butterfat and $ 5.01 per kg protein. However, the return varies from farm to farm depending on the percentage of butterfat and protein in the milk. An average Friesian herd in spring may only produce milk with 3.9% butterfat and 3.2% protein. The dairy payment system sees the farmer generally being paid a better price for their milk between the months of January to July. Payments made to dairy farmers are generally less in the remaining months of the year.

At this test around 14 litres are needed to produce 1 Kg of milk solids. This equates to around 48 cents per litre gross. (48.2c per Dairy Australia – Focus 2019) The measurement by litre is important in the recommended solution to the crisis articulated later where effectively there is a transfer to the dairy farmer of $0.40 a litre without any deduction from the retailer through the processor as trustee for the dairy farmer. This is not based on solid counts but a litre count.

The nature of payment by the Processor to the dairy farmer is by solids, not the milk, and the milk includes water. This is both curious and a paradox. By paying only for the solids, this is an advantage for the Processor in producing other dairy products such as cheese because these products have far less water than drinkable milk.

The Processor sells drinkable milk, which has a low percentage of fat and protein to the supermarket in volume, this includes water in the milk, as does the supermarket to the consumer. In a sense, the dairy farmers are not being rewarded for the water that keeps milk a drinkable product.

By contrast, the producers or Processors of soft drinks, as with the retailers, have the benefit of selling their product with water without having to pay significantly for their key ingredients, save perhaps for Coca Cola. The perception of the consumer will be that the farmer has been paid for the milk they drink and consume it, not just the solids.

With the water in the drinkable milk, it is curious that:

- the consumer enjoys and pays the retailer,
- the retailer pays and is well paid,
- the Processor pays the dairy farmer for the fat and protein content but the residue of the drinkable milk is free,
- the dairy farmer receives nothing for the residue.

The Retailers use their power to deny the Processors and the Dairy Farmer the value of permeates to standardise protein levels in the milk estimated to cost them at $10M.

There is no justification for the water content of drinkable milk to be free.

Why milk is so cheap in Australia

The corporatisation of Murry Goulburn (MG) has been a disaster as has been the deregulation. The raising of capital through ASX listing created two masters. The dairy farmers are now suppliers where MG endeavoured to extract the lowest possible milk solid price.

Historically dairy cooperatives arose out of the dairy farmers' need for collective milk bargaining. The cooperatives were owned by the dairy farmers as members and operated exclusively for their benefit. By consolidating milk supply and processing it,

it was indirectly the members who secured a fair price. *A price that aimed to support the sustainability of the farming enterprises and ensure surpluses for capital accumulation.*

It was the cooperatives which balanced some of the power of the Processors but the retail oligopoly has even more power. Murray Goulburn take over by Saputo has been a disaster where the farmer's power has been further substantially reduced. Saputo is now setting itself up as the pricing gate keeper as it undertakes to process the milk of the smaller Processor who can't cope with the overflow milk which they cannot put into shelf stable export product like cheese or powder.

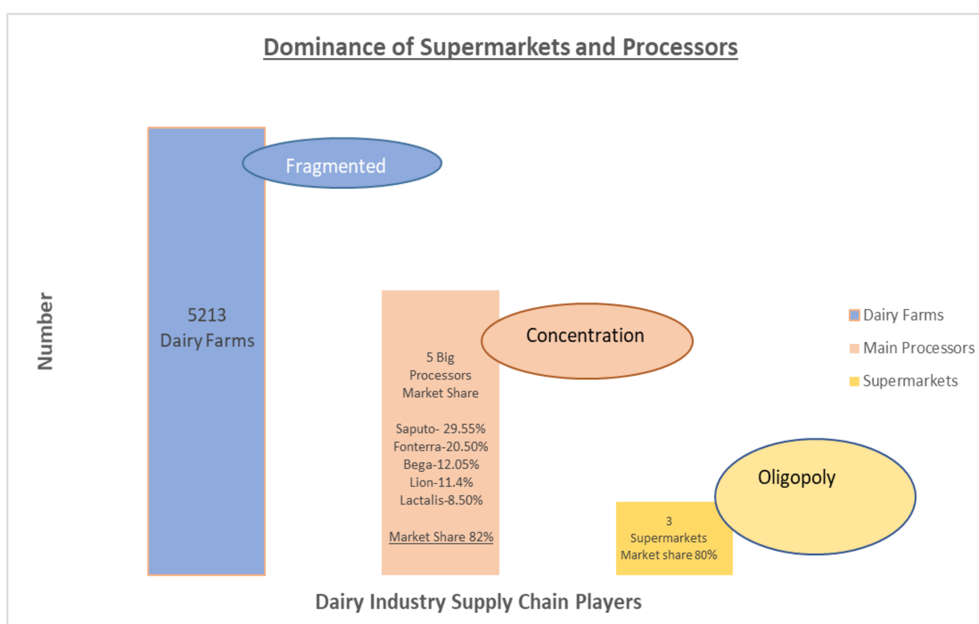
The Processors require a return on their capital. The retail oligopoly exercised their power for volume at decreased prices. The Processor had no alternative but to decrease the milk at the farm gate.

The corporatisation of Processors has been a mistake for the dairy farmer and the economy. NZ and India have proven that in spades.

Table 8 below shows structure of the market with:

- The concentration of the Processors and Retailers,
- The fragmentation of the dairy farmers.

Table 8: Dairy Market Structure



One litre of milk sold at $1, shared by the supply chain as follows:

	Farmers	Processors	Retailers	Total
Price Share	$0.45	$0.37	$0.18	$1.00
% Price Share	45%	37%	18%	100%

One litre of milk sold at an average of $1.20 since March 2019, out of increased 20c, only 10c are shared by the Farmers in the supply chain:

	Farmers	Processors	Retailers	Total
Price Share	$0.55	$0.41	$0.24	$1.20
20c share	$0.10	$0.04	$0.06	$0.20
% Total Price Share	46%	34%	20%	100%

Note that in going from $1.00 to $1.20, the retailers increased their share of the price increase from 18% to 20%. The farmer earnt only 1% and the Processor is down 3%.

Dairy Farms

In 1980 there were approximately 22,000 dairy farms. Now in 2018-19, an estimated 5,213 dairy farms were registered with Dairy Australia. Approximately:

- Victoria 67%, NSW 11%, Tasmania 8%,
- Queensland 7%, SA 4% and WA 3%

And this number is shrinking rapidly.

If you look at Victorian dairy producing areas and include Southern NSW, you would add a further 240 farms making the total of the Victoria 3,756+ farms, by far the largest dairy market.

Table 9 shows the total number of dairy farms in Australia fell by around 60% from 2000 to 2019 and Table 10 shows the number of cows in Victoria has declined by 34% since deregulation.

~~Rabobank in The Australian Newspaper 18 December 2019 indicated that since July 2019 the number of milking cows have reduced from 144M to 107M, a drop of 5.8%. This represents a $500M drop in revenue.~~

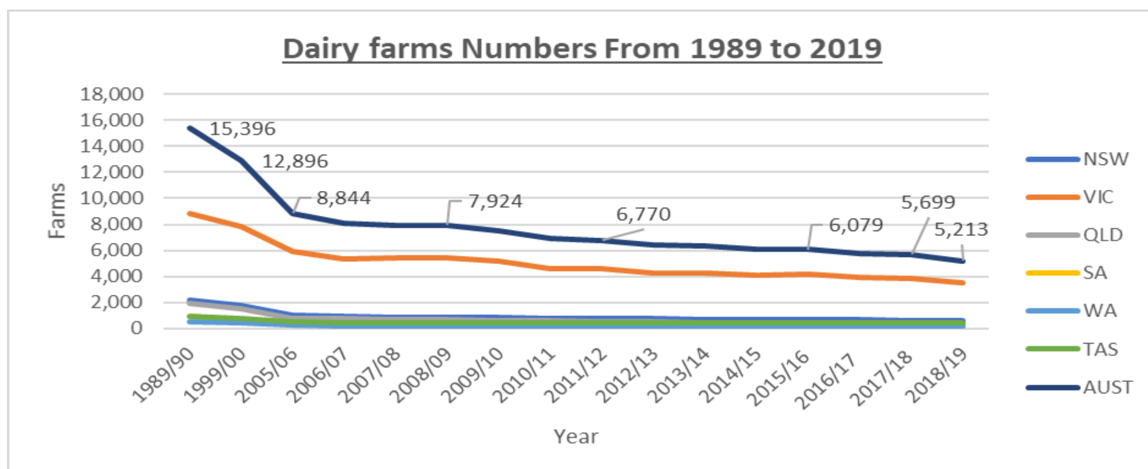
"Some recently released data showed the Australian dairy industry starting the new season on July 1 with 1.44m head of milking cows. This is 7% (or 107,000 head) below the previous season."

Further:

"For the season, Rabobank has revised down its milk production forecast. The latest expectation is for national production to decline by 5.8%, to 8.3bn litres. On a volume basis, this represents another loss of 500m litres of milk."

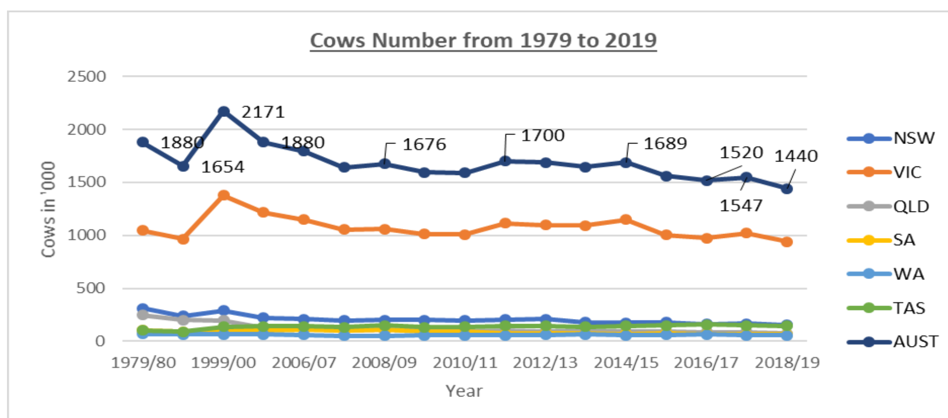
Rabobank Dairy Quarterly Q4 2019 Report

Table 9: Trend of Dairy Farms since De-regulation



(Source: Dairy Australia)

Table 10: Trend of Cow Numbers Since 1979



(Source: Dairy Australia)

According to Dairy Australia, the average dairy farm in Australia is:

- Farm size 273 cows
- No of Farms 375
- Milk produced 1.657 million litres.

Table 11: Dairy Farm – Size and Output

					Revenue increase by increase of milk price			
Farm Size	No of Farms	% age	Cumulative %	Milk Litres	15 cent	20 cent	25 cent	30 cent
					$	$	$	$
75	469	9%	9%	455,250	68,288	91,050	113,813	136,575
100	234	4%	13%	607,000	91,050	121,400	151,750	182,100
150	235	5%	18%	910,500	136,575	182,100	227,625	273,150
200	525	10%	28%	1,214,000	182,100	242,800	303,500	364,200
225	596	11%	39%	1,365,750	204,863	273,150	341,438	409,725
250	414	8%	47%	1,517,500	227,625	303,500	379,375	455,250
273	375	7%	55%	1,657,110	**248,567**	331,422	**414,278**	497,133
300	332	6%	61%	1,821,000	273,150	364,200	455,250	546,300
350	330	6%	67%	2,124,500	318,675	424,900	531,125	637,350
350	298	6%	73%	2,124,500	**318,675**	424,900	**531,125**	637,350
400	296	6%	79%	2,428,000	364,200	485,600	607,000	728,400
500	275	5%	84%	3,035,000	455,250	607,000	758,750	910,500
600	217	4%	88%	3,642,000	546,300	728,400	910,500	1,092,600
700	200	4%	92%	4,249,000	637,350	849,800	1,062,250	1,274,700
800	150	3%	95%	4,856,000	728,400	971,200	1,214,000	1,456,800
1200	142	3%	98%	7,284,000	1,092,600	1,456,800	1,821,000	2,185,200
1300	125	2%	100%	7,891,000	1,183,650	1,578,200	1,972,750	2,367,300

Recent ABARES Australian Dairy Industry Survey stated that average Farm (273) incurs a loss of $55k, without covering the costs of unpaid family labour or set aside funds to replace depreciating farm assets or changes in payment systems.

Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES)

Note: The above Table 11 deals with revenue not profit increases. The average farm of 273 cows, incurs a loss of $55,000 without taking into account the cost of unpaid family labour and depreciation set aside for asset improvement. Even if only a $0.20 increase is achieved it would merely put a farm around break even. The $0.20 delivers $331K or about 20% increase in revenue. In fact, an increase of $0.40 is required for a solid improvement. That would still be below the world average price.

The Dairy Farm Monitor Project using 75 Victorian dairy farms spread evenly across three Victorian dairy regions conducted by Agriculture Victoria. The Report in 2018-19 there was a negative shift in the distribution of farm performance. Note from Table 13 that where the capital is invested. We must be careful with this as the figures are averages. This needs further analysis if the information is available.

Of the 75 farms sampled 29 (39% of participants) recorded a negative Return on Total Assets (RoTA). Table 12 details the Assets, Liabilities & Equity of sampled farms studied. Whilst the current farm gate dairy price looks better because of the drought levy when adjusted for the huge increase in cost inputs it will not solve the problem.

Dairy Farm Costs

The current price of $6.80/kg for milk solid appears on face to be attractive but this is illusionary. This fails to take into account the huge increase in costs facing most dairy farmers. This will continue in the short-term and some in the long-term. So, revenue / cost is out of balance and many dairy farmers are making a loss.

Since 2000, the average dairy farm profit has been approximately $22,818 per annum (Department of Agriculture and Water Resources 2018). This compares to the national minimum wage of $38,512 per annum for a 38-hour week (Fair Work Commission 2019). This suggests that the income for an average Australian dairy farmer is much lower than that of the minimum wage despite the farmer working 7 days a week all year round.

Where are these costs? Against the background of a dairy farm of 357 cows as explained by Agriculture Victoria Annual Report 2018/19, Dairy Farm Monitor Project shows in Table 12:

Table 12: Average Victorian Farm Income Statement

Victorian Farm with 357 cows			
Dairy Farm Monitor Project | Agriculture Victoria | Annual report 2018-19			%age to Revenue
INCOME STATEMENT			
Milk Income (Net)		1,144,132	
Other Income			
Livestock Trading	98,609		
All other Farm Income	12,180	110,789	
GROSS INCOME		1,254,921	
VARIABLE COSTS			
Herd Costs	60,566		5%
Herd tests and breeding			
Animanl Health - drench, parasite			
Vaccines, injections, drugs			
Vet Fees and services			
Calf Rearing			
Shed Costs	39,004		3%
Electricity, Gas, fuel, cooling			
Dairy Supplies - rubberware, chemicals			
Milk liners, claw tubes, milk & air hoses			
Feed Costs	670,665		53%
Bought in Feed			
Home Grown Fodder			
Hay and Silage making			
Pasture and Cropping incl seeds			
Fertilisers			
Water Costs			
TOTAL VARIABLE COSTS		770,235	61%
GROSS MARGIN		484,686	39%
FIXED COSTS			
Overhead Costs	240,474		19%
Repairs & maintenance			
Rates, Taxes, insurance			
Telephone, waste, admin			
Imputed Labour Costs	117,122		9%
Depreciation	41,778		3%
TOTAL FIXED COSTS		399,374	32%
Earnings before Interest and Tax (EBIT)		85,312	7%
Interest and Lease Costs		109,553	9%
NET FARM LOSS		-24,241.0	-2%
Return on Equity		-0.76%	
Return on Owned Assets		-0.49%	
Returned on Total Assets		-0.42%	

BALANCE SHEET			
Assets Leased	813,683	Equity	3,178,352
Assets Owned	4,981,298	Liabilities	1,802,946
		Accumulated Losses	813,683
ASSETS MANAGED	5,794,981	Total - Liabilities & Equity	5,794,981
Note: - This table based on average cow size farm of 357 in Victoria			
Table 11 (Dairy Farm - Size & output) in this paper represents national average farm size of 273 cows			

The following is where there is a significant cost squeeze. For each region and each dairy farmer within each region the impact will be different but all dairy farmers are suffering one or more of the costs in the above table. This is an illustration only.

SHED COSTS

Shed costs, which includes all the chemicals and similar items to run the farm have been increasing at the rate of 4% per year. Similarly, vet fees have been increasing at the rate of 5% per year. Labour costs have remained relatively stable but one needs to compare family labour against external labour.

ENERGY

Dairy farms are hugely dependent upon energy. As an example, 5 years ago, the cost per kilowatt was 20c with a night time rate of 13c. It is now 32c per kilowatt hour and 17c for off-peak. Hence, the energy costs have increased by 60% over the last 5 years and will increase further from 1st January 2020. This has added a significant cost to the farmer.

WATER

The cost is water where some farmers are more dependent than others either for rain or the purchase of water is very significant. At best, a dairy farmer can afford $200 per mega litre for water based on comparing with the cereal hay 5 years rolling average. At that price dairy farmers are significantly stretched but now the cost per mega litre is over $1000 making it prohibitive for some farmers with the consequence they have failed.

FEED

With the lack of rain and heavily priced water, the cost of grain in varying varieties has escalated significantly. The increases vary from 20% to 40%. The prices paid

at the farm include a massive amount of freight. The freighters appear to be taking advantage of the situation and overcharging. The Government subsidy for freight is not helping very much. Further, the home-grown fodder is very expensive as well and it includes seed, grains, conversation costs to silage and hay, fertilisers and water.

FERTILISERS

With the state of farms, fertilisers have become more important. Farms need more fertilisers and whilst there has not been a dramatic increase in the cost of fertiliser, but more fertiliser is required.

Each one of the above costs it is quite significant and clear that almost all dairy farmers will be affected by one or more of these cost imposts. Some cost imposts like energy and costs are unlikely to change. Hopefully water and fodder costs may improve.

What has happened with the yield? There is information to suggest that notwithstanding the crisis, the yield is stable and has improved a little. This is because many dairy farms have de-stocked by 10%-20% and it is this de-stocking that has enabled them to maintain yield.

The difficulty for the dairy farmer is that the retailer, the Processor and the public see $6.80/Kg MS as an improvement but that does not reflect the reality of the economics of the farm including the payout system. For other information about the economics of farming generally see Appendix 3.

Dairy Farm Capital Structure

Table 13 below shows the structure of a dairy farm with 357 cows. The capital required is quite significant and dairy farmers are entitled to a return on that capital which they are not receiving. The larger the dairy farm, the better the capital structure.

Table 13: Average Capital Structure of Farm in Victoria

Capital Structure of Farm in Victoria									
Source: Dairy Farm Monitor Project | Victoria | Annual report 2018-19									
Average herd size - 357 cows									
Farm Assets					Other Farm Assets (per usable Hectare)				
	Land Value	Land value	Permanent Water Value	Permanent Water Value	Plant & Equipment	Livestock	Hay and Grain	Other Asssets	Total Assets
	$/HA	$/Cow	$/HA	$/Cow	$/HA	$/HA	$/HA	$/HA	$/HA
Average	$11,937	$8,543	$6,753	$3,807	$1,111	$3,459	$257	$303	$20,150
Top 25%	$12,045	$8,197	$2,829	$1,424	$1,108	$3,575	$207	$338	$20,102

Liabilities		Equity			
Liabilities per usable hectare		Liabilities per milking cow	Equity per usable hectare	Average Equity	
	$/HA	$/Cow	$/HA	%	
Average	$7,169	$4,801	$12,981	64%	
Top 25%	$6,582	$4,406	$13,519	68%	

Processors

There are around 500 milk Processors in Australia. The dominant players and their market share are:

Saputo	29.55%
Fonterra	20.50%
Lion	11.40%
Lactalis (Parmalat)	8.50%
Bega	12.05%
Others	18.00%
TOTAL	100%

Lion and Mengniu (Burra) together will have a market share of 14.80%.

The remaining small Processors like Burra (3.4%), Norco, Bulla, Brownes, Union Dairy and others have market share of 18%. ***In some dairy product sub-markets, one or more of the Processors is dominant. This exacerbates the problem.***

Retailers

The total annual milk production for the year 2018-19 was 8,795M litres with a farm gate production value of $4.4 billion, of which 2.484B litres drinkable milk (value add $3B) was processed and with the value $4.051B sold by Retailers (including Supermarkets). With unsatisfied demand and drinkable milk not accounted for, it is likely that the market is about 3.4B litres. This is an opinion which cannot be supported by direct evidence but it is a considered one.

With a $0.40 increase on farm gate price, the drinking milk sold of 2.484B litres will have a carry value of $992M on the top of $4B, which is 24.8% of the total sales respectively of drinking milk.

The other milk products produced were:

- Cheese 381,111 tonnes,
- Milk powder 224,107 tonnes,
- Cream 150,249 tonnes,
- Yoghurt 123,983 tonnes, and
- Butter 73,322 tonnes.

60% of drinkable milk is sold by Coles, Woolworths, Aldi. At $1.20 a litre, the extra 20 cents are shared as follows:

	Increased Price Share		20 cent increase share	
Farmgate	$0.55	46%	$0.10	50%
Processor	$0.41	34%	$0.04	20%
Retailer	$0.24	20%	$0.06	30%
	$1.20	100%	$0.20	100%

Coles attempted to deal directly with dairy farmers but without success.

Who suffers?

The number of dairy farmers exiting farms is escalating, with total milk production and head of cattle falling rapidly. Some are exiting because of the drought, the shortage of water and others, simply because it is no longer economic.

Milk Processors require economies of scale in order to process and sell milk competitively. Losing the advantage of scale through reduced volumes makes them less economic.

The dairy industry is facing rising cost inputs. The industry is in a price/cost squeeze from which, in the current structural circumstances, there is no escape. **The squeeze will, in the absence of government intervention worsen.**

There is evidence that many dairy farmers are reducing equity with bank loans to meet on-going operating costs. This means that consumers and milk Processors, are being subsidised by the extraction of equity from the dairy farms. The Processors and particularly the retailers are all making money.

Some consolidation of dairy farms is desirable; however, the current crisis has catapulted the dairy industry way beyond desirable and advantageous consolidation. Without 'consolidation' this will continue to eat into farm equity. Their blind faith in 'better times ahead' will take them to the bank manager for further loans, and then eventually a forced sale. The government has a moral obligation to put a stop to this unconscionable, un-Australian and grossly unfair state of affairs which is no fault of the dairy farmer.

Many dairy farms have debt to earnings ratios that are unsustainable. Generational succession for such farms will not work. The farm must be - and will be - sold at some stage. The negative economic and social implications of such a destructive trend for the families concerned, for the regional towns, and for their communities is obvious. It is not just about helping the dairy farmer; it is a much wider social problem. *Refer Table 13: Average Capital Structure of Farms in Victoria.*

Supermarket Economics

The dairy category is a crucial part of supermarket merchandise mix. Both branded and unbranded liquid or drinkable milk are in the top five regularly purchased items following cigarettes, confectionery, bread and soft drink.

Customers have a huge awareness of milk prices. If milk prices do not align with other supermarkets, it will reflect on the customer's view on pricing generally and its brand. There is a high probability that milk will be included in customers basket estimated at 18% of baskets. Further, milk ranks in the top 5 in terms of sales.

Any upward lift in the price of milk might affect volume and the perception of supermarkets pricing generally. This is all the more important because there are few substitute products only 8% of milk sales. Whilst milk has a 14-day shelf life in the supermarket, unbranded milk would turn over every seven days or less and branded milk (10) days. Milk is usually in the customer's fridge for 8 days on average.

Milk is distributed by the big Processors to the national supermarkets differently to the small supermarkets where there is some direct delivery.

The profit margin on unbranded milk for an independent supermarket is around 10% (but the ACCC believes it is 18%) and branded milk 20% (ACCC 50%) so with a stock turn of 2 days or 183 times and 5 days or 73 times, the gross margin return on stock or its productivity is between 1460 and 3660.

As a volume-based product, milk although on a lower margin than other dairy products, delivers, because of its volume, huge gross profit dollars and is very important to the overall profitability of supermarkets and the return on funds employed. Even though milk requires refrigeration (further cost) and takes more space than many other products (measured in size and value to sales), it is nevertheless a very big contributor to profits; a very important supermarket category.

By contrast the other dairy products like cheese, yoghurt and butter have an average of 35% margin but the stock turn would be way less as anything between 30 and 35 days or say 11 to 12 times (12x35=420%). So, ROI is 420, way less than milk. Block cheese earns lower margins and specialised cheese margins at the higher

end, often 50%.

Every supermarket's dairy product mix is different, but if you work on the basis of an average margin of say 30% for the whole category, with say 21 days of stock and a stock turn of 17 times for an independent supermarket, the gross margin return on stock is high at 510 making a significant contribution to profits. The space and refrigeration costs would not be material.

A trend in the cheese and related products is that whilst the block cheese earns a lower margin there is a trend for shoppers to acquire the more exotic cheeses where higher margins are earned so the change in mix helps profitability. As every supermarket has a very different mix of product and a different position on regular pricing, the table below enables you to plot where the various products fit.

Note the plotting of information in Table 14 below: Note that for a supermarket, stock is its biggest investment. Because of the stock turn, some supermarkets have a negative working capital as creditors are less than stock. Further most supermarkets lease their sites plant and equipment so there is minimum capital investment will result in a high asset / sale percentage and high return on the capital invested. In Table 14, the margin (%) and stock turn means you have a very successful business.

Table 14: Return on Investment on Stock

ROI on Stock (Stock Productivity)									
Days in Stock	50	40	30	25	20	15	10	5	2
Stock Turn Times	7	9	12	15	18	24	37	73	183
Margin (%)									
10	70	90	120	150	180	240	370	730	*1830
15	105	135	180	225	270	360	555	1095	2745
20	140	180	240	300	360	480	740	1460	3660
25	175	225	300	375	450	600	925	1825	4575
30	210	270	360	450	540	720	1110	2190	5490
35	245	315	**420	525	630	840	1295	2555	6405
40	280	360	480	600	720	960	1480	2920	7320
45	315	405	540	675	810	1080	1665	3285	8235
50	350	450	600	750	900	1200	1850	3650	9150

*Unbranded drinking milk ROI of 1830 at 10% margin with 2 days in stock,

**Other dairy products ROI of 420 at 35% margin with 30 days in stock,

It is the stock turn that is driving performance and milk is incredibly attractive because of its volume and gross profit dollar contribution.

What is clear is that a supermarket cannot unilaterally increase the price of milk without effecting volume. Supermarkets would substantially damage its brand and image with shoppers if all supermarkets did not increase prices. **This alone is a very powerful reason why there must be intervention.**

The above table, as simple as it looks, has profound implications. One item sold at a margin of 50%, is not as attractive as two items sold at a margin of 30%. The later earns more gross profit dollars. This demonstrates the tyranny of percentages. We are too accepting of percentages as measures. If you measure the gross profit dollars you would be better off. This also applies to profit statements where we blindly accept a percentage of income or a percentage of cost as the only measure. It goes both ways. Sometimes a percentage is satisfactory and other times not. We need to look at the absolute amount as well. See generally, an excellent book, 'The Tyranny of Metrics' by Jerry Z Muller.

The assumption that underlies this for stock management is that one product at 50% is not as good as two at 30% assumes that you can achieve the extra volume. There is a relationship between volume and price or percentage. The reality is that some products are more sensitive to volume when manipulating price than others. The art is having an intimate and working understanding of this interplay. In other words, the art is when, where, how and why can you use price to generate volume and more gross profit dollars. If you are comparing the same items, it is likely the cost of achieving this will be almost the same. But when looking at disparate products the cost of achieving volume can be quite different. Again, the art is having an acute understanding of the direct costs and the contribution to or the fractionalising of fixed costs. This is where data analytics is having a field day in influencing retail decisions and where the future of retail lies.

To buyers, Table 14 (above) is the first cut in making decisions and fractionalising fixed costs although not the only aspect, it is critical. So, you must understand cost behaviour. In a retail business, you need to look at the entire portfolio or mix of product as to when you seek percentage gain or gross profit dollars. Again, this is an art which distinguishes the better operators and formats.

Table 14 is the first cut in the analysis. On the left-hand side of the matrix table you should add for each category the sales and gross profit dollars. If you accept the target of a minimum of 500% return, they can easily identify underperformance. You can look deeper at the performance of suppliers in each category and SKU's for each supplier. This can be undertaken also by store, region or state. In other words, a vast amount of data can be generated, analysed and simply charted by the data analysts to help make much better decisions and help negotiate with the supplier where information can be shared.

Where there are extra costs in some categories, like excess space and refrigeration, you can introduce weighting or require a premium over targets. With dairy, clearly milk has huge volume and stock turn opportunity so pricing is critical; it is price sensitive and elastic with other dairy products like cheese, it is not as easy to stimulate volume because the customer's needs are more discretionary, intermittent and less sensitive to price and availability but more often to range.

Small Price Increase, Little Consumer Effect

The table below shows the impact of a 15c, 20c, 25c, 30c and 40c price increase in the retail price of milk on the profitability of farmer's by farm size.

Table 15: Price Increase Sensitivity Analysis

			Profitability increase by increase of milk price				
Farm Size	No of Farms	Milk Litres	15 cent	20 cent	25 cent	30 cent	40 cent
			$	$	$		$
75	469	455,250	68,288	91,050	113,813	136,575	182,100
100	234	607,000	91,050	121,400	151,750	182,100	242,800
150	235	910,500	136,575	182,100	227,625	273,150	364,200
200	525	1,214,000	182,100	242,800	303,500	364,200	485,600
225	596	1,365,750	204,863	273,150	341,438	409,725	546,300
250	414	1,517,500	227,625	303,500	379,375	455,250	607,000
273	375	1,657,110	248,567	331,422	414,278	497,133	662,844
300	332	1,821,000	273,150	364,200	455,250	546,300	728,400
350	330	2,124,500	318,675	424,900	531,125	637,350	849,800
350	298	2,124,500	318,675	424,900	531,125	637,350	849,800
400	296	2,428,000	364,200	485,600	607,000	728,400	971,200
500	275	3,035,000	455,250	607,000	758,750	910,500	1,214,000
600	217	3,642,000	546,300	728,400	910,500	1,092,600	1,456,800
700	200	4,249,000	637,350	849,800	1,062,250	1,274,700	1,699,600
800	150	4,856,000	728,400	971,200	1,214,000	1,456,800	1,942,400
1200	142	7,284,000	1,092,600	1,456,800	1,821,000	2,185,200	2,913,600
1300	125	7,891,000	1,183,650	1,578,200	1,972,750	2,367,300	3,156,400
Recent ABARES Australian Dairy Industry Survey stated that average Farm (273) incurs a loss of $55k, without covering the costs of unpaid family labour or set aside funds to replace depreciating farm assets or changes in payment systems.							
Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES)							

Even a $0.40c increase in the retail price of milk for the average size farm of approximately 273 cows, producing 1.6 million litres of milk per year, would increase revenue by $662,844.

The above assumes that the price increase is paid straight through the Processor to the farmer without deductions by the Processor.

A price increase of $0.40c to take milk to $1.70 represents a 31% increase. This is relatively very small compared to the variations of vegetables which could be 100% or meat and seafood at 50%.

All Dairy Farmers Benefit Model

- All dairy farmers in Australia should benefit from a more realistic and fair pricing of drinkable milk (milk) through Supermarkets and Resellers generally.

  Dairy farmers:
  - do not control the final destination of their milk and so
  - should not be disadvantaged because each Processor has a different manufacturing and selling mix.

  Not all the registered processors are selling drinkable milk to resellers so the distribution of the increased price by the resellers through the processors will not be equitable for dairy farmers.

  So the increased notional price for drinkable milk should go to all dairy farmers in proportion to the litres of milk delivered by them to the Processors.

  This means that:
  - An intermediary, like Dairy Australia or Australian Dairy Farmers Ltd or an accounting firm, should receive the payment from the resellers for distribution to the dairy farmers in proportion to their litres delivered to the Processors.
  - The pooled amount available each month should be paid to the intermediary at the same time the Processors are paid by the Resellers.
  - The intermediary would divide the pooled amount available by the litres supplied and establish a rate per litre of milk delivered to the Processors.
  - The intermediary with the details of litres provided by the Processor in advance of a payment being made, should mean that calculations can be made so that the dairy farmer is paid simultaneously with payments to the Processor.
- This is a simple, low-cost model, timely and efficient process.
- This could be audited, say quarterly to establish if:
  - the dairy farmer litre-age is correct,
  - notionally increase in price by the resellers is correct,
  - paid to the intermediary at the same time as payments to the Processor,
  - Intermediary paid the correct amount to the dairy farmers.

  A quarterly audit certificate to this effect should be delivered to the:

- ACCC and / or its website,
- Intermediary,
- Processors (if requested),
- Resellers (if requested),
- Dairy farmers (if requested).

Anyone can appeal to the ACCC if:

- any irregularities,
- given the objectives, any unforeseen gaps in the process requiring rectification,
- have all dairy farmers been identified and their litreage correct,
- if resellers have not paid the intermediary?

How much should the Resellers set aside for the dairy farmers irrespective of how they reprice the milk?

Using an example, 2018-19 figures from Dairy Australia, 8,795 million litres of milk was produced and delivered to Processors.

The destination of the milk was as follows:

	Litres (million)	Percentage
Exports and Non Drinkable milk (solids)	6,311	71.75%
Drinkable Milk	2,484	28.25%
TOTAL	8,795	100.00%

Using the 2018-19 drinkable milk litre volume of 2,484M litres, the notional prices increase below, the amount paid to dairy farmers would be approximately one third as follows:

Milk Price per one litre carton ($)	Proposed increase in price (cents)	Cents per litre for the dairy farmer
1.29		
1.49	20	6.7
1.54	25	8.3
1.59	30	10.0
1.64	35	11.7
1.69	40	13.3

The above represents a small increase of dairy farmer revenue and not a total solution. This should be understood but it is a great start.

What should the rate be?

- My paper established Australian, drinkable milk at $1.29 is by far the cheapest in the developed world:
    - New Zealand is $2.51
    - The world average is $1.70
    - The developed world average is $2.40
- The decision by government that an amount of $0.40 only matches the developed world average of $1.70 is still way below NZ.

In making a decision, there are some critical issues:

- Dairy farmers have been penalised for some time so there is an issue of catch up in lost revenue since deregulation.
- The importance of milk to our well-being is critical as compared to other drinking products eg. wine, soft drink, water, beer etc. This is ridiculous and is an insult to the dairy farmer.
- Other drink products are priced higher than milk.
- Our dairy sector has been suffering poor profitability, the sector is declining as is its share of exports.

  Fruit and vegetable pricing gyrates from sometimes as high as 50% and 100% based on issues of supply, demand and seasons.
- Some dairy farmers are earning less than many occupations but have a capital investment and subject to seasons and many other risks.
- Dairy farmers are locked into long-term contracts by Processors with Processors putting downward pressure on the dairy farmer returns.
- The retail oligopoly is too powerful for both the Processors and indirectly the dairy farmers. This justifies intervention.

  The dairy farmers currently have a huge cost / price squeeze of considerable proportions but also drought and fires for some.
- We are a long way from India and New Zealand.
- If the facts are put to them there is a high probability the consumer will accept

price increases even if $0.40.

It is up to the retailer whether the retailer sets the price of $1.70 or elects to absorb part of the increase.

- My paper on Supermarket Economics shows that supermarkets are making a healthy return out of drinkable milk and very high returns out of solids. If anything the solids subsidise milk. Together these categories will cope with more generosity for both Processor and dairy farmer.

  Even at a price increase $0.40 or 13.3c for the dairy farmer, this only partly helps the dairy farmer but it is very good for dairy farmer morale and shows the Government cares and is doing something.
- There is growing tension around dairy farmers as more fail with the current fire crisis adding to the damage done by the drought.
  - "Fair Go Dairy" is about to go national and will be very aggressive,
  - Dairy Farmers cannot understand why Senator Hanson's solution was not adopted or there was not some negotiation. Codes will not fix the problem,
  - The National Party had great success with the intervention with Section 46 of the Competition Law. Why not repeat?
  - The government is intervening with electricity.
- Overall it is easy for the ACCC to supervise etc. and report to government as outlined in in my paper.
- Coles $1 milk was, as Adam Smith would describe, not self-interest but selfish. It had a short-term effect on its competitive position but with the response of all of the retailers with the same pricing, the only consequence was unconscionable impact on supply chain and dairy farmers in particular.

  The government is justified in intervening for the reasons my paper describes.
- My solution is simpler than Senator Hanson's solution which while well-meaning and well-intended, it is a little clumsy (refer pg35 of this paper for the mechanics).
- My earlier work established that dairy farms with 800 plus cows are more profitable. So you could benefit dairy farms considerably with less than 800 cows being 92% of the total number of farms:
  - Is this fair?
  - Where do you draw the line?
  - What about gaming?

- What about one owner, with 800 cows at multiple sites.

- The table below shows that the 417 'larger' farms or 8% of total farms produce almost one third of the milk production. The remaining 4,796 or 92% of Australian dairy farms, produce almost two thirds of the milk production and will receive a much larger benefit:

	Farms	Percentage	**Milk produced Litres '000**	Percentage
Larger Farms	417	8.00%	2,749,103	31%
Balance	4,796	92.00%	6,045,897	69%
TOTAL	5,213	100.00%	8,795,000	100.00%

You could have a sliding scale of benefits with little benefit for the super-sized farms. See Table 11 from my paper, The Dairy Industry Crisis. The Case for Government Intervention for more detail on dairy farm size. Dairy Australia classified farms in more detail as follows:

Farm Size	Number of Farms	Percentage
XX-Large	417	8%
X-Large	417	8%
Large	1,199	23%
Medium	2,242	43%
Small	938	18%
TOTAL	5,213	100%

- Dairy farms need to be authorised by the ACCC to negotiate as a group of by state, dairy district or Processor market:
  - The Processors have too much power,
  - Processors need to pay more to dairy farmers.
- It should not be a delay by reason of having to establish the intermediary as from the following month retailers can accumulate the benefits to dairy farmers until the intermediary is in place. It might take a few weeks if the government elects to issue a tender for who should take up the intermediary role.

Mechanics of Payment by the Intermediary

- The intermediary to collect from the Processors all relevant details of the dairy farmers including the litres delivered each month to the Processors.
- The processors to inform the intermediary within five days of the end of each month, the details of the drinkable milk delivered to all resellers and the amount the resellers must pay to the intermediary when paying the Processors.
- The intermediary, with the information from the Processor, can calculate all monies due to each individual dairy farmer so that when monies are received by the intermediary from the resellers, simultaneous payment is made to the dairy farmers so that they are paid at almost the same time as the Processors pay the dairy farmers each month.

Confidentiality

Dairy farmers should not see:

- Other dairy farmers information,
- Processors information,
- Re-sellers information.

Processors should not see:

- Non-dairy farmer client information,
- Other Processors information,
- Other non-client re-seller information.

Re-sellers should not see:

- Individual dairy farmers information,
- Non-processor client information,
- Other re-seller information.

To repeat

- This is a very simple, low-cost process and the tender price for an intermediary taking on this role should be relatively low.
- To repeat, until the intermediary is in place, the resellers can commence accumulating the notional increased price until it is in place. There can be no excuse for delay.

What about <u>the elasticity of the price of milk</u>?

We have attempted, unsuccessfully to find data from the Processors, the Advertising Agencies and the Retailers who would all research this subject. The only literature identified is a paper by Deakin University Economic Series, called Food Demand Elasticities for Australia. This paper looks at the various food categories including dairy. This was only of marginal help and suggests that had the 10% GST applied to milk products, this would not affect demand. It is an open issue, the extent to which $0.40 would reduce demand. It would probably only be slight and for a limited time only, particularly with our population growth.

Why Should We Help the Dairy Farmer?

Except for a limited annual dry period, most dairy farmers are committed to work seven days a week, from dawn to dusk and without respite.

Notwithstanding the significant capital investment, the seasonal (weather), financial, physical and emotional risk, farmers earn less than school teachers, police, nurses, fire fighters, public servants and health professionals. Note from earlier comments, on dairy farmer cost, the average profit at $22,818 is less that the minimum wage of $38,512. This is appalling an unacceptable. These people are all paid regularly and fewer of them are at risk of losing their jobs and certainly pay is reviewed regularly and always adjusted for inflation. There are also many hard and soft benefits. Usually the farming enterprise is a family business. All members tend to be implicated and together suffer the fate of the business.

In the table below, you can see the average salaries paid to many employees. The table does not include the very substantial benefits they receive like:

- Bonuses,
- Long service leave,
- Extended holidays,
- Superannuation,
- Penalty and overtime payments,

- Sick leave,
- Parental / maternity leave,
- Many other benefits unique to this particular class of employee.

	Category	Average Base Salary
1	Nurses	63,784
2	Protective Services Officer (PSO)	64,393
3	Fire Fighter	64,745
4	Primary School Teacher	66,150
5	Police Constable	69,836
6	Tram Driver	75,000
7	High School Teacher	85,000
8	Paramedic	85,855
9	Carpenter/Joiner	91,500
10	Train Driver	113,000
11	MP (Victoria)	182,413
12	MP (Federal)	211,250
13	Public Servent - APS1 to SES3	52256 - 425,066
20	Public Servent - All Ave.	143,403

For dairy farmers, particularly the family dairy farm, the members do not receive many, if any, of the benefits above. No wonder dairy farmers leave the industry with the current drought and fires, what will stop this accelerating?

Dairy farmers are not unionised and that is not helping their cause. The nature of their work requires them to either continue to milk usually twice a day, or risk damage to their herd and - as a result - to their finances. Farmers will not pour milk down the drain. Such practise is viewed as irresponsible and selfish.

With capital and on-going costs, farmers are committed to continue to milk regardless of returns or loss. They do this also because they need to fractionalise their fixed costs. To stop milking, would cause greater cost as there are costs that continue.

Regional Economies

A number of regional economies depend upon the dairy sector as the dairy industry employs around 46,200 direct jobs (In Focus 2019, Dairy Australia) and there are around 100,000 indirect jobs.

A recent Situation and Outlook report forecast a 3.2% increase in global dairy

demands. This is against the Australian share of the global dairy trade has fallen from 16% in the 1960’s to just 6% in 2019 and the Australian Dairy output will fall further this year.

Why Should We Regard the Dairy Crisis A National Emergency?

This crisis is not just about dairy farm viability. The collapse has the potential to cause wider damage to the quality / quantity economy and society. For instance, we could threaten export income, deny consumers milk, waste capital and how do we redeploy the people and save local communities. For this reason, the crisis ought to be regarded as a national emergency.

The dairy industry structure is causing market failure. Later material describes the structure of the NZ and Indian sectors and you can see how disadvantaged the Australian dairy farmer really is. The seriousness of this market failure and the impending collapse justifies urgent and immediate government intervention.

There are several possible ways to intervene:

- Voluntary or enforced codes of conduct by the ACCC giving the codes the force of the law,
- industry restructure,
- price control via regulation and
- authorising dairy farmers to negotiate together by State or by the market of the Processor on pricing and terms.

Codes of conduct are helpful but are limited in impact. They do not address the prevailing structural defects. They are also the product of consultation and compromise. The result is often a document that favours one of the players over the other. Note the ACCC met on the 18th December 2019 to discuss with representatives of 19 industry bodies to agree upon the code of conduct. According to the ACCC release the meeting was to discuss education and compliance issues and implementation. This group will meet quarterly for the next 6 months. This shows how difficult and how much time it takes to reach agreement and implement. This will suit the Processors and retailers who must be laughing about the delay. The politicians will

believe this will silence the farmers up for the next 6 months, after all, there is only 5200 of them and they have no unified voice. No one can talk with authority on their behalf. There is no effective negotiation.

Codes of conduct are notoriously difficult to enforce even when given the force of the law by the ACCC. Has the ACCC the time, interest or resources to monitor and enforce? This power imbalance makes codes of conduct a shield behind which Processors may continue to game the system with impunity. Codes of Conduct are playing around with the problem at the margin and not facing the fundamental reality.

The Processor code enables dairy farmers to sell milk to alternate Processors, in essence, a non-exclusive supply arrangement. This only slightly changes the power imbalance between the dairy farmer and the Processor but it will not increase the price of their product or effect retailer power.

Price regulation is necessary at two levels: the price that Processors receive for their product from retailers, and the price by the Processors to the farmer. It is not enough to regulate just the farm gate price. In such a scenario the Processors will be left to the mercy of the retail oligopoly. The Processors will not be able to negotiate and pass on any price increases to the retailers. So therefore, both farm gate and Processor prices must be regulated.

Most observers agree that the downward pressure on retail prices as applied by the retail oligopoly requires market intervention. The retail oligopoly has too much power in this market, and it has the ability to influence the welfare and future viability of Processors and dairy farmers. In their quest to compete and jockey for market share, the oligopoly is destroying the very enterprises which supply them. Only market intervention can put an end to excessive competition between retailers. Self-correction is unlikely. There has been support for change and no change has happened.

The retail oligopoly has ultimate control of the supply chain. Unless that fundamental issue is addressed by price regulation, there cannot be an effective and sustainable solution.

Peter Harris, the highly regarded former Productivity Commissioner, commented on

the Productivity Report on the Dairy Industry in June 2014:

- Dairy farmers need greater incentive to keep producing milk,
- Australian dairy farmers receive some of the cheapest milk prices in the world,
- Productivity gains by dairy farmers have underwritten profits for dairy manufacturing and in recent years sustained the industry,
- He acknowledges that milk price may be the answer.

Peter Harris is a very competent Commissioner and his words carry great weight.

It is an opportune time now to address this issue, while many farmers are also facing drought and water shortages and when their welfare is the top of mind for the public. There is considerable public sympathy for dairy farmers. It is part of the Aussie culture, a fair go and help your mates. Consumers do not mind paying extra for their milk. After all, **MILK IS CURRENTLY RETAILING FOR LESS THAN FILTERED WATER.**

Price regulation will not alarm the consumer as the price increase only needs to be between 20c and 50c a litre. This would not alarm the consumer compared to the dairy farmer's pain.

Demand / Supply – Livestock & Dairy

What is happening with demand and supply economics?

When demand is relatively constant and supply is either falling or is forecast to fall, prices rise. The converse also applies. This dynamic assumes an open, free, and transparent market. In other words, an efficient and fair market.

Through the current drought conditions and the prevailing economic malaise, the sheep/cattle and dairy markets are responding differently. Cattle and sheep numbers have been falling dramatically, with sale prices rising, as one would expect. This signifies an efficient market. Sheep and cattle farmers have greater control over the sales process, including the timing of a sale. This is not the case with dairy farmers.

There are many individual cattle and sheep farmers selling stock in different markets and sales channels, and not just locally, but are sending stock to markets across Australia. The cattle and sheep market enjoy a greater geographical market spread than does dairy. Dairy farmers' market options are limited. They must sell locally due to the imperative to process the product within a short time and the cost of freighting over long distances. The dairy farmers' market is therefore a limited market, controlled almost exclusively by the retail oligopoly. Is not an efficient market.

Codes of Conduct

Note that the current Draft Dairy Code of Conduct does not give the dairy farmer the opportunity to select amongst several contending purchasers, it obliges him to sell to a singular buyer (Processor). The Processor would not want a part of the farmer volume. Remember in some cases the Processors offer some farmers rebates for volume to keep the farmer away from the competition. This arrangement is discretionary and means that the dairy farmer cannot enjoy the fruits of increased seasonal demand (higher selling prices) for milk. The Code effectively legitimises the locking out of dairy farmers from the market; they become surfs of the Processor kings, who together with the retail oligopolies reap all the advantages, leaving the crumbs and more inherent risks to dairy farmers. This state of affairs is not morally acceptable. It is un-Australian, unconscionable and unfair. It is also reckless to allow this state of affairs to persist from a sustainability point of view.

Dairy farmers do not have the opportunity of bargaining together where they talk with the one voice and act together as one. They are essentially an individual, all on their own. In India they are unionised and so have real power.

A code of conduct is a snap shot in time. It is usually very prescriptive, attempting to resolve the anxieties of warring parties. But you cannot freeze a situation as sectors and circumstances change. What happens is the parties being unable to forecast changes in structure and behaviour mean the code becomes unsuitable. This particularly happens when the codes themselves change behaviours giving rise to further unacceptable behaviours. A code cannot be dynamic and reflect ever changing dynamics of a sector. So sometimes one of the parties is worse off as a

result of a code. Given the time it takes to negotiate a code it takes a similar amount of time to see change.

In Codes with too much prescription this is often followed by intensive gaming. Before the ink on the code is dry, the gaming commences. Why? The lawyers representing the large corporate's will be trying to limit the prescription and will be attempting to include wriggle room for gaming. As codes by their very nature, restrict corporations, they do not like this. Corporations do not like being curtailed. This often has an impact on the costs or income and certainly narrows freedom. So not unnaturally they resist and devote considerable legal resources to these codes.

This is why principle-based Codes are preferred over rule-based Codes (see later OECD comments comparing rules and principle base codes). The OECD comes down on the side of rules and prescription because this brings, according to the OECD, certainty. But in my view, principle or rule-based codes are not binary, there could be hybrids.

For instance, the principles or objectives of the code could be laid out with a listing illustrating the do's and don'ts. This gives an opportunity to lay out the background and reason for intervention, the anxieties and the risk. So you can have principles and then a listing of the unacceptable or behaviours or actions. In addition, you could articulate the concept of unconscionable conduct which embraces some of the ideas in the statutory provisions and common law.

If you wanted to rely upon unconscionable behaviour you could have a form of arbitration or decision by a jurist. Most jurists are adept at establishing when unconscionable behaviour exists. If the code becomes a statutory code, the ACCC can play a role and cut through the behaviours and get to the real issues.

Despite the above, nevertheless no matter whether the code is rule or principle based or whether it is a hybrid, this will not provide a satisfactory solution in the dairy sector crisis.

The conclusion is that codes are not very successful in dealing with an inefficient market or a poor structure where there is an imbalance of power. The issue is you must face up to the fundamental problem. Intervention is required to alter the

imbalance of power and the unfair structure.

Many dairy farmers resent this market restriction. In order to maximise their returns, they seek to secure the right to sell to more than just one purchaser. In other words, dairy farmers seek an open, competitive and efficient market. It is therefore extraordinary that the Agriculture Minister has taken the current Code to the market for testing. The instrument defies economic logic. Such an agreement is the very antithesis of Adam Smith's moral sentiments and his behavioural economic logic.

Adam Smith believed that the market works best when individuals pursue their own economic goals on the basis of mutual but not exclusive benefits, and not to the detriment of anyone else. In other words, the individual charts his own course on the basis that someone wants his products or services. If his products and services do not match the needs of the customer, then he must modify his behaviour accordingly and so on.

When large numbers of people behave in this way, a market based on individuals' freedom and choice arises. When the market is operating efficiently, the exchanges ought to benefit all participants and participants evolve and change their behaviour and actions to meet other needs and meet the market. To interfere with such a market will cause dysfunction and it will frustrate innovation, change, productivity, efficiency and demotivate. For farmers to benefit, it is not only choice that they require. They require the market to be free, open, transparent, and efficient. The dairy market is today largely controlled by an oligopoly. Adam Smith condemns oligopolies, as they interfere with and destroy the free market.

There ought to be intervention to address the imbalance of power and information. As it is the oligopoly in this chain is catching most of the rent, to the exclusion of the Processors and the farmers. The dairy supply chain lacks integrity and fairness. The Processors are profitable, the supermarkets are very profitable, the dairy farmers are struggling and we have by far the cheapest milk in the world.

Urgent intervention in the form of a price regulation authority, is required to fix both the farm gate and the Processors selling prices, so as to save the industry from its collapse. Price controls before deregulation worked well.

Unfairness

Rod Sims, Chairman of the ACCC, is frustrated with the standards of corporate behaviour. His concern is that the statutory and common law principles of unconscionable conduct or unconscionable behaviour standards are too low. He would like to see a further but lower threshold of unfair practices. See unconscionable conduct and unfairness in Fiduciary Obligations by Paul Finn pg.312.

In theory, this is a great idea and would appeal to Adam Smith's concept of the difference between selfish and selfishness. But the jurists would have difficulty defining this new concept.

Maybe the answer is that initially this does not come a legal concept enforced by law but where something can be declared to be unfair and let the market make a judgement about what it should do about such a declaration. This could be a very good preliminary to understanding the boundaries of such a new concept and with a number of declarations this could help the jurists provide definition. This could lead to adverse consequences, somewhat less than those applying out of unconscionable behaviour and conduct. Note the legislative progress made on 'Unfair Contracts' which over time could be extended in scope and coverage.

Milk Exchange

A tech company, 'Milk2Market' has launched a digital milk exchange platform creating a virtual marketplace for dairy farmers. On the platform, dairy farmers and Processors can connect freely in an open market environment. At the moment there is no milk market. Similar platforms exist in other countries. The Federal Government is also considering a similar platform with a cost of $560,000 (Stock & Land, 28 November 2019, page 20). Whilst this is a good concept, it does not challenge the reality of the Processors having the power. The power imbalance does not change so the fundamental problem is not solved.

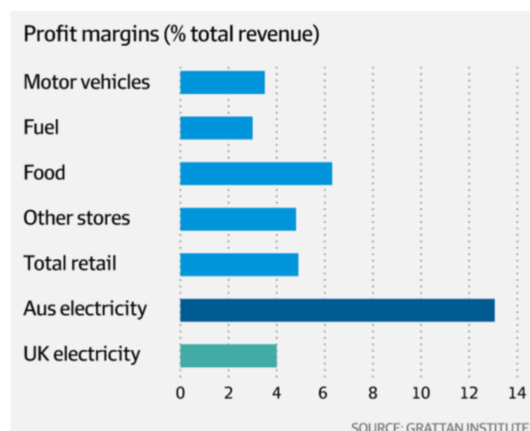
A Comparison with the Electricity Market

We should compare the electricity market and the dairy farm market and the competitive behaviour of the participants. There are some common features in both markets. The dairy market, it is dominated by the retailers. The retailers are forcing down the price of milk for the benefit of the consumer but to the serious detriment of the farmer.

In the electricity market, the retailers also dominate that market and disadvantages the consumer to the benefit of the retailers. The result is that the energy company profits have skyrocketed and the cost to the energy consumer has risen 60%, from around $.20 per kWh to $0.32 kWh. It has now gone to 0.38kWh for households as from 1st January 2020.

It is interesting to see this against a chart from the Grattan Institute which shows the margin various sectors are achieving. It is clear the energy and food retailers are doing very well (see Table 16).

Table 16: Industry Profit Margins



The market is failing both in the energy and in the dairy sector and there should be government intervention. With energy, the governments jawboning has not changed the behaviour of the energy companies. Energy costs continue to rise and the energy companies' profits rise. The energy companies lobby has been critical of any form of government intervention, but as you will read later, their argument is flawed. The inappropriateness of government intervening in a free market. Why wouldn't you if you are making those huge profits?

In the energy market consumers, both commercial and households, are suffering so significantly that the government is attempting to intervene and pass legislation giving the ACCC, the power to force the divestment of assets. It is alleged the energy companies are manipulating capacity to influence supply and demand. By reducing capacity by closing a power plants or threatening to do so, you are forecasting reduced supply so stimulating demand and putting consumers in a position where they have no choice but to accept the increased prices because of the structure of the market and the complete lack of choice.

Why will not the Government do the same in respect to the dairy market?

You could assume that as there are only around 5213 dairy farms whereas with energy you are talking about millions of businesses and householders who are feeling the cost increase now and very directly so there are issues of Government performance and votes. Both these situations are the same and the Government should be just as active in respect to the dairy market. In both cases the Chairman of the ACCC has acknowledged, that under Competition Law he does not have the power to deal with the energy companies pricing and similarly, in the dairy industry. So, to that extent, Competition Law is failing.

It is a shame that both the strategy and common law of unconscionable conduct has not developed further so we have catchall provisions where as we deal with this behaviour which is clearly unconscionable and unacceptable to the ordinary man? There are some statutory, unconscionable conduct provisions but they do not help here.

The ACCC has tried and is frustrated by its lack of legislative power but it has succeeded in dealing with *Coles Supermarkets offer of 10c for farmers*. <u>The ACCC found that on investigation that 10c was not being passed on to farmers.</u> Instead of litigating the issue, the ACCC has reached agreement with Coles and the full 10c is now being paid direct to 270+ Norco Co-operative Limited (Norco) farmers. The ACCC argues there are technical deficiencies in the Law and Coles cannot be charged for deceptive and misleading conduct both to farmers and to the general consumer. **We now find that Lactalis Australia has also deceived the dairy farmer by paying $0.06c less.** This raises the issue of integrity and trust of

Processors. With the Bank Inquiry the underpayment of wages and Coles behaviour, the corporate sector is continuing to lose reputation. Maybe the recommended treatment of the dairy farmer here might go some way to recovering the reputation of at least the retailers.

The consumer market will be very unimpressed and it falls into the category of **Westpac's poor behaviour on money laundering legislation.** It will not help Coles but regrettably consumers have short memories and in time it will be forgotten but clearly for a short time, in the eyes of the man in the street it is unconscionable, unacceptable and un-Australian behaviour.

Against this background you can understand the frustration of farmers pleading for the Government to intervene on their behalf. All we have is further inquiries without any resolution. The dairy farmers are defenceless and have no legal or economic lever to apply other than winning the argument with the public. If the issues were clearly known and put to the public, the sympathy would be on the side of the farmer and that is what Australian culture is all about.

<u>It is important to put the above in context of the actual figures.</u> On the basis that the average Australian consumes around 99 Litres of milk per year and according to statistics, each household has 2.6 occupants, this means that a 40c increase in the price of milk would only cost the consumer $0.80 per week or $40 per year or the household $1.30 per week or $67.60 per year for a very healthy and critical food item. All Australians would agree that this is a small amount to save the dairy farmer and promote the dairy farm industry.

By contrast, the electricity market, the average consumer over the last few years has found that an average energy bill has increased from $1,200 to $1,600 (Grattan Institute) 33% and similarly, SME businesses from $5,500 to $7,000. This has a far greater adverse impact on the consumer than the small amount required to save the dairy industry.

There are:

- 5213 farms (and shrinking in numbers),
- 9.4M households,

- 2.313M businesses,

paying energy costs.

So, who has the loudest voice in Canberra? Every electorate will be feeling the stress. Who is closest to the politicians? The pressure for energy concessions is infinitely more powerful than the 5213 dairy farms. Why will not the politicians be more sympathetic to the dairy farmers?

To reply upon codes of conduct is nonsense. The Processors want to negotiate / regulate down prices in given circumstances. There are no provisions about price increases. All the risk is being held by the dairy farmer. This is a quagmire and a waste of time.

China Risk (Lion, Mengniu Takeover)

It is important to understand the dynamics of the dairy farm market before reaching any conclusions about what The Foreign Investment Review Board (FIRB) should do with the transfer of the Lion dairy farm assets to the Chinese company Mengniu Dairy. If approved it will be one of the largest in Australia.

Some farmers welcome this because it brings certainty, reliability and an operator who understands the dairy market in China and Australia and may facilitate greater exports into China which might lift the demand for milk. This is a limited view.

In looking at the structure of the dairy industry in China and Australia there are considerable differences. In China there are two huge world and large-scale Processors, Mengniu and Yili who dominate the dairy market. According to newspaper reports these Processors make it very tough for dairy farmers on price notwithstanding there has been greater consolidation of dairy farms and the dairy farms are larger. It appears that the Processor who dominate the dairy farmers can withstand the pressures from the retailers and resellers of their products. This is perhaps because the Processors cannot satisfy the demand in China so all milk will be processed into export products for China.

By contrast in Australia it is the retailers that control the supply chain. Their power is initially exercised against the Processors who then in turn hand the pain on to the

dairy farmer. For Australia, the issue is the price the farmers receive for their milk.

What could happen with the takeover by China?

First, there is an important issue about who controls Mengniu. Mengniu is a listed company in Hong Kong with headquarters in the tax haven of the Cayman Islands which in turn is 31% owned by a joint venture COFCO (China Oil and Foodstuff Corporation) one of China's state run food processing companies. The COFCO Group is China's largest processor, manufacturer and trader, involving the Chinese Government and partners Danone of France and Anla Foods of Denmark. We are therefore entitled to assume that the Chinese Government either directly or indirectly has material influence on Mengniu so it is likely that the forefront of Mengniu's objectives will be the Chinese national interest not that of Australia. With this kind of tax structure, it is likely to be classified by the ATO as high risk to our tax system.

In this scenario, what could happen is that Mengniu acquires a number of dairies enabling an integration of their supply chain. With this control Mengniu could concentrate on the export market thus starving the Australian market of drinkable milk. The Chinese prefer the Australian product to their own and it sells at a premium in China. There is more consolidation of power by the Processor against the farmer. Mengniu can withstand influence from our retailers by simply exporting.

The other issue is technology. Australia has some dairy farm technology and what is the basis of a transfer of that technology to China? Conversely international companies are prone to acquire Australian technology for nothing but then lease or license their own technology to the Australian entity at a cost so syphoning off Australian profits and tax.

In a situation like this with transfer pricing, it is very easy for the Australian Mengniu interests to substantially minimise tax. We need to know, what is Mengniu's performance in relation to the payment of Australian tax with Burra and similarly what is the history of other Chinese companies in Australia?

The Government is currently passing laws in relation to foreign interference and this raises the issue as to how that should apply to foreign companies trading in Australia. Foreign governments can use their national companies trading in

Australia to interfere and behave in their own national interest. This issue needs to be debated and considered before FIRB comes to a conclusion about the takeover by Mengniu. There should be full disclosure by Mengniu.

There are some interesting statistics about China's involvement in Australia. Surprisingly China is, according to the table below, the second-largest landholder in Australia just beating the UK. This is surprising as UK has been investing in Australia since Australia was discovered. This means there has been a massive recent catch up by the Chinese in the acquisition of Australian land. There is nothing intrinsically wrong with this as long as these purchases are not used to pursue the interests of a foreign government. See the size of foreign agricultural land interests by source country.

Table 17: Size of foreign agricultural land interests by source country

Country	Foreign owned portion ('000 ha)	
	2016-2017	2017-2018
United Kingdom	9,752	10,239
China	9,112	9,169
United States of America	2,550	2,655
Netherlands	2,509	2,540
Bahamas	0.2	2,201
Canada	2,034	1,984
Switzerland	1,888	1,944
Hong Kong	279	1,273
Philippines	1,121	1,120
Saudi Arabia	660	665
Singapore	1,763	512
South Africa	648	648

Another surprising statistic is water, where China is the biggest holder of our water (see Table 18 below). Fortunately, in respect to water, this cannot be exported but again we need to understand the objectives of foreign companies owning such key resources as water and land.

Table 18: Foreign held water entitlement by country

Country	Foreign held water entitlement (GL)	Foreign held water as a proportion of total water entitlement on issue (%)
China	732	1.9
United States of America	720	1.9
United Kingdom	411	1.1
Canada	212	0.5
Singapore	172	0.4
France	139	0.4
Switzerland	136	0.4
Belgium	102	0.3
New Zealand	100	0.3
Netherlands	92	0.2
Total for top 10 countries	**2,815**	**8.2**
Total for all foreign countries[12]	**3,371**	**9.1**
Australian owned portion of water in Register	664	NA
Total including Australian owned portion	**4,035**	**10.4**

It will be difficult for FIRB to refuse to transfer from one foreign country to another. That is a superficial view as the seller, Lion, it is not a committed dairy industry player so their acquisition was mainly to acquire the beer brands and it is not unreasonable that they should now want to divest a non-core asset.

So, to move from one foreign entity to another, the issue is not so much whether they should be given permission but the conditions upon which they should. Note that Japan is a democracy with a free market, whereas China is the opposite. Note the Government's anxiety about Huawei where there is a risk of foreign interference. There is also the issue of the transfer of technology out of Australia without protection and payment. Note also China is desperately short of drinkable milk, milk powder and other dairy products. So, who will Mengniu look after first? **It is clear what China would do, starve Australians.**

Clearly there needs to be conditions about tax and about their market objectives. We know that the codes of conduct have limited value. How can we be sure that the balance of power between Processors and farmers is fairly exercised? What is important is that if conditions are imposed that these are real and they can be monitored and that there are serious penalties including divestment if they are not honoured. You can be certain that the Chinese Government in reverse, whether directly or indirectly, would have no compunction about conditioning a transaction

like this and ensuring that the acquire meets the objectives of their country not that of another.

Market Intervention

Philosophically there is nothing wrong with intervening in a market when it has failed. In fact, it is a moral imperative. Adam Smith (1770) the great moral philosopher, who was the father of free market thinking, agrees that when the market fails it is not only okay to intervene but it is the Governments moral obligation to intervene.

This is not about intervening in a fair, free and efficient market. Intervention is about re-balancing the power of one member of the supply chain. The re-allocation of some of the rent exclusively to the dairy farmers will stimulate dairy sector and lead to more innovation and investment. This is much better for the economy. It is not re-allocating welfare or inappropriately spending tax payer dollars but re-building a once vital and successful part of the agriculture sector with plenty of export potential. Above all else, it is a humanitarian gesture which is part of the Australian culture. The more involvement means it is only a question of communicating to the consumer the reason for the $0.40 and its potential to improve the economy. This will not be difficult to articulate and be seen to be consumer friendly.

<u>The Coalition Government should have no ideological difficulty in intervening. It has intervened in the electricity market, and it is contemplating intervening in the media market against international players like Google and Netflix: and rightly so.</u>

IT IS A FAIRLY SIMPLE MATTER TO INTRODUCE PRICE REGULATION.

Treasury Secretary <u>Dr. Steven Kennedy</u> said in an address to the Government Economist Conference in Canberra on 19 November 2019 that governments are increasingly under pressure to intervene in the market economy to fix perceived problems for everyday Australians. He urged public sector economists to help develop "well designed and well-regulated markets" to improve the outcomes of Australian" (AFR dated 20 November 2019, page 9).

In the electricity market, where consumers are paying excessive prices and where

Government jawboning is not having any effect. The Government is seeking legislation to force as a last resort, divestment by energy companies of assets. The Government is intent on ensuring electricity retailers pass on reductions in wholesale electrical prices to consumers. This will make it easier for smaller energy companies and new entrants to compete as an energy retailer.

Whilst the dairy industry is the reverse, where the effect of retail prices, although advantaging the consumer, is damaging the farmer. It is unlikely that in the circumstances the consumer would object to a price increase of 10c to 40c to save the farmers but it will only work if all retailers similarly increase the price.

The structure of the dairy industry in Australia is causing unconscionable damage to the dairy farmer. This requires Government intervention to correct the imbalance in the market and to ensure that the competition is efficient and fair.

What would Adam Smith do?

Adam Smith (1751-1776) the writer of the enduring books, The Theory of Moral Sentiments (1759), The Wealth of Nations (1776) and others, and the architect of the free market economy: the one which underpins capitalism. Smith's lessons were delivered in words not numbers. He is perhaps the first and most enduring behavioural economist. His writings are not underpinned by algebraic formulae and questionable assumptions, as is the case with many of the works of today's macro economists. His views about freedom, choice, and the importance of respecting the individual underpin much of Western Civilisation's values. Values which today are under attack from the left.

Adam Smith has a fundamental observation that self-interest is not in accord with being selfish or grass greed. See the discussion in "Lessons from the Global Financial Crisis – the Relevance of Adam Smith and the Morality of the Free Market by Richard Morgan at page 72".

"Prudence is related to self-interest, self-reliance and a sense of wellbeing and happiness. It is self-regulatory virtue that fosters the right of people to the bettering of one's lives; the latter does not entail the cult of greediness and something

economists as socially detached individuals is that it demands not only the propriety of self-command also the approval of the impartial spectator".

Adam Smith's views are acutely relevant to the dairy crisis because the dairy industry does not currently operate in a 'free market', a market where there exists a balance between buyers and sellers. There exists instead a consolidation of powerful retailers (oligopoly) and many much smaller, unorganised, and powerless suppliers (dairy farmers).

The dairy market cannot be regarded as an open and free market. Its current dynamics constitute the very antithesis of Adam Smith's enduring philosophy. Smith would regard the market as acutely distorted due to the oligopoly's power to set prices and to abuse the market by unconscionably sucking every drop of value it can from the powerless dairy farmers.

Adam Smith had clarity of mind and purpose, and the ability to explain clearly in words the underlying values of his economic doctrine. Tragically, the defective and destructive aspects of our economic system are currently not being clearly articulated by our economists.

What would Adam Smith's position be today?

Firstly, he would say that competition law is not relevant to the game, and it is dealing substantially with behaviour, and not with structure, save for in the case of mergers. Adam Smith would agree that in the current scenario, intervention to set prices is essential.

The elephant in the room is structure. It is structure which drives the behaviour in the supply chain, and in the case of the dairy industry, renders competition law ineffective. The market is fundamentally distorted.

It is difficult to secure changes in competition law through Parliament. Section 46 entailed a massive struggle and was legislated only because the National Party demanded its passing when negotiating the Coalition Agreement on the appointment of Scott Morrison as leader and Prime Minister. The Government honoured this commitment in spades. In ordinary circumstances such legislation would never have

been acceptable to the Liberal Party.

Section 46 was worth the fight in order to support small and regional businesses. Now, even some oligopolistic disruptors (media) appreciate it as they themselves become disruptees. The National party deserves great credit for driving this important stake into the ground and improving competition law in Australia against the wishes of the big end of town.

Even left-wing economists at the universities will agree that this intervention was appropriate. However, Section 46 is not sufficient to deal with necessary structural reform required in the dairy industry.

The old Section 46 failed, not because of its objectives or theory, but because of evidentiary issues. The sinner must be seen to have 'taken advantage' of its market power so in effect there needed to be intent. Further, if any other corporate could do the same thing, the courts held there was no sin. Few cases succeeded because of the huge evidentiary barriers in proving intent of taking advantage.

Initially this was the only one of the Harper recommendations which was not initially accepted by Government. Big business and their big law firms protested loudly and effectively. What followed was a storm and dispute essentially between big business and small business. After a great deal of argument, it was accepted that the Harper recommendations should be accepted and there did not need to be intent to take advantage of market power. There just had to be consequences or outcomes of using market power. So it was not necessary to prove intent. Even after these amendments, the Section is not strong enough to deal with the dairy situation.

It is the nature of the retail oligopoly that the mere fact of the structure and a few players and lack of choice by suppliers and farmers that the retailers can simply dictate their pricing and you cannot establish that this is an abuse of power. Even though the retailers have all adopted the same minimum price of $1.29 per one litre carton, you cannot establish that, that is parallel behaviour which is also illegal. Parallel behaviour implies some positive action by the retailers to work together. Indeed it is the opposite, they do not want their competitor to have an advantage by having a lower price.

Parallel behaviour usually occurs with maximum prices as is a bone of contention by the ACCC with the banks. Rod Sims of the ACCC has vented, as have others, the frustration about not being able to deal with an oligopoly or a monopoly power. An oligopoly or monopoly under Competition Law is not per se, illegal, it is the actions and behaviour that might cause breaches of Competition Law.

Section 50 deals with merger as the only one, that deals with structures and the disadvantages of structures where there is too much concentration. But this is nowhere near good enough to deal with the many oligopolies that we have in Australia.

There exists an oligopoly ecosystem in Australia. For instance, the big four accounting, law, and consulting firms all depend substantially upon the food retailing oligopolies for their ‘bread and butter’. It is not surprising therefore that they are on the side of these oligopolies in lobbying and in public debate. Their power and influence are all persuasive and they dominate the corridors of Federal Parliament. Just look at how long it took the Government to set up the Banking Royal Commission.

Banks also need Market Intervention

Banks have always been extraordinarily complex businesses with a number of disparate businesses like department stores, very difficult to manage and direct. The Hayne Inquiry has demonstrated just how much the banks are out of control and difficult to manage. Even with tighter compliance programs post Hayne, the banks will not be able to manage their businesses as others like the resource companies, media and retailers.

Technology is compounding this making it more challenging as banks use technology to standardise with less person to person contact. This presents huge opportunities for the Fintechs who with simple business models, have great technology and simpler compliance regimes nimble, gradually taking away huge parts of the banks business. No one Fintech is a silver bullet. There are simply hundreds of them, nibbling away at the edges of the various parts of a bank’s business. It will be difficult for the banks to thwart these imposters because they are

efficient, focused, highly intelligent and close to their customers.

The banks by contrast cannot compete with these models where the levels between the CEO, management and the customer, by comparison with the banks, are much closer. So which coupled with technology, enables better tailoring of customer relationships.

The banks are hiving off of superannuation, insurance and financial advisory services but this only goes part of the way to simplifying the big 4 bank model so that they can compete with the emerging Fintechs. Banks should, in the interest of customers, shareholders and good public policy, contemplate significant demerging and accept the reality they cannot directly manage as well as the Fintechs.

Glass Steagall is a model that could be followed where the Retail Bank is separated from the Business Bank.

Some will oppose this, like Treasury and APRA, where it is easier to control and deal with systemic risk in 4 entities with 80% of the market. This too is a case for Government intervention, encouraging de-merging by supplying stamp duty and capital gains tax exemptions in the interest of better capital formation and a more efficient economy and benefits for the consumer.

For Government the issue is with Banking and Dairy. "When should the government intervene?" *In the US the government has intervened to break up the oil monopolies and the banks with bank separation. This resulted in an overall improvement in the performance, productivity and efficiency of the economy.*

It may be difficult for a government to secure powers of intervention to break up an entity. There are many who will oppose such intervention based on political ideology. It must be recognised that the problems in the dairy industry have arisen since - and because of - deregulation. **The de-regulation was influenced by the Hilmer Review on competition policy where it was believed there was no public benefit in regulating dairy.** How wrong this has turned out to be. In the early days, dairy co-operatives were owned by the dairy farmers and served their interests only. Following their corporatisation, they serve the interests of shareholders who are mostly not in the dairy industry. Their aim is making a profit - for themselves and at

the expense of the farmers - and servicing capital. This sudden reversal of purpose has left the dairy farmers exposed and extremely vulnerable.

It is paradoxical that the dairy retail oligopoly (Woolworths, Coles and Aldi) engage in fierce and healthy competition to extract the best deal for customers from the Processors, and indirectly, from the dairy farmers. By contrast, the banking oligopoly does not compete to put the customers first. They work together to put their customers last. In banks there is a three-way conflict between borrowers, lenders and banks. Banks use their arbitraging power and leverage too much for their own benefit, and to the detriment of others.

The problems with our banks and with dairy, are caused by structure. Our banks are universal providers with a portfolio of activities, some of which are quite disparate. This broad range of activities is difficult to manage. Clearly the Hayne Inquiry has established that the banks are not managing their portfolios very well and it is an open question as to whether they ever will. Many aspects of banks are being successfully attacked by fintechs, some of whom are gaining handy market shares.

Against this background it is interesting that Wesfarmers and now Woolworths, have and will demerge some of their portfolio of retail assets. Evidently Wesfarmers has created $16M in value by demerging and it would not be surprising if Woolworths does not similarly create considerable shareholder value.

You have to ask the question, why banks will not follow particularly as they are not managing their activities well. Maybe the explanation is that banks as arbitrageurs with a three-way conflict want as much opportunity as they can to take advantage of arbitraging and demerging would restrict that activity. But it is clear that demerging of the banks would produce considerable value for shareholders. Customers would be better off and regulation could be more targeted and less one size fits all. It is interesting that the CEO of Wesfarmers had the foresight and Woolworths the humility to acknowledge that Woolworths (a very successful company) could not manage all of its activities and by demerging entities the demerged entities could be more tightly managed with better or optimal capital allocation in the interests of shareholders and customers. Can you imagine a bank CEO or bank board making a similar comment?

The Hayne Inquiry has established just how poorly the banks have been managed. This may not change materially. Why?

The wider a bank's portfolio of assets, the better the spread of risk but this conflicts with the interests of the customers who as a result of the bank portfolio risk approach, these leaves areas of unsatisfied demand. This does not satisfy the customer. So you have this conflict between portfolio management and spread of risk against consumer demand. The former also always wins in the interest of minimising systemic risk. Given that the big four control 80% of the market, there is exacerbated by sameness and some parallel behaviour. This compounds the problem for customers and is bad for the economy. The bigger they are, the more arbitrage available and demand for bigger salaries by clipping more tickets. The banks need to demerge, not only in shareholder's best interest but as good public policy. See extensive papers written on this later.

Banks are very powerful creatures in our environment and not only do they want as much arbitrating opportunity as they can, the bank likes the existence and exercise of a great deal of power in the economy. The more arbitraging opportunity the higher their salaries power and influence on the economy. The power enables them to command huge salaries.

We have seen with the Hayne Inquiry, where abuse occurred to the detriment of the consumer. With dairy, the benefit has been for the consumer to the detriment of the dairy farmer where there are only 5000 dairy farmers as against millions of consumers.

The tyranny of metrics hides the dairy farmer's disadvantage and there is a lack of awareness by the public and the politicians as to the reality of their situation.

Oligopolies represent an unfortunate and undesirable structural defect in the Australian economy. This is partly because of our size; big fish in a small pond. We have oligopolies in banking, in retailing, in the media, and in the airline industry. In the resource sector the product is mainly exported so it does not matter. The banking oligopoly is reinforced by the big four accounting firm's oligopoly where the incestuous activities between the big accounting firms and the four big banks as evidenced in the Westpac drama is not in the interest of our economy, it is

unhealthy. This will be difficult to solve because of the concentration of accounting and banking power and their relationship with Government. So it is not only sameness and co-operation between the banks but it is the same with the big four accounting firms where huge revenues and benefits are earnt and shared out of the banking sector. The banks would be their largest clients. This is because there is limited alternatives as usually one or two are conflicted and so the choice is between two, hardly a contest in a tender and easy to game. The bank sector would be, by far, the biggest payer of audit and consulting fees. Senior executives of the banks and accounting firms become Directors of the other bank. Just look at the CV of a bank director. No other country in the Western world tolerates such a concentration of commercial power.

The key problem is the oligopoly ecosystems which extend across the economy. The structural defects are recognised, but only by a few. Their voices are not being heard. No action is being taken to correct this defect.

The world-famous University of Chicago 'let it rip' School of Free Trade, with its brilliant mathematicians, would have agreed with the deregulation of the dairy market, yet the dairy market has failed post deregulation. (See generally, Competition Law in Australia, SG Corones 5th Edition). There has been plenty of time and opportunity for it to adjust, and to find a rewarding path through the current crisis. Instead, deregulation has brought the dairy market to the point of collapse.

Further consolidation of Processors will compound the problem. It is not the solution. Some farmer consolidation may assist to improve efficiencies, but this will have insignificant impact. Farm consolidation does not address the issue of unconscionable and un-Australian price squeezing by the retailers and the Processors. It is likely a boxing match with a heavy-weight competing with a feather-weight and a powerless referee who is reluctant to intervene. That will go on regardless. Eventually even the most efficient of the consolidated dairy farms will fall victim even though the Processors often offer volume relative to the bigger players.

The physical supply of milk is currently efficient. There is a history of steady productivity improvement. Productivity improvement cannot make up for the defective market structure. It is now clear that the oligopoly and its ecosystem

manifests as an abuse of market power. The oligopoly is capturing too much rent and it is destroying the dairy industry.

There exists no realistic substitute for milk. Although it is acknowledged that the small drop in the per capita consumption of milk has been caused by soy, almond, oat, rice and other alternate options partly motivated by the growth in vegetarianism, plant-based diets, medical concerns, lactose intolerance and fat in diets. Often substitutes solve the problem in unfair and ineffective markets. Importing milk from overseas is not viable and sufficient. The government must face the reality of the dairy crisis. It must deal with it urgently. It ought to introduce price regulation immediately. Announcing legislate as soon as possible but hope that retailers recognise the reality and adjust prices before the legislation is effective.

The governments of other nations (like NZ and India) would not tolerate this looming dairy disaster. They would not stand by and allow the pricing power of the oligopolies to drive down prices by unconscionable means, reduce milk production, diminish Processor scale, and send dedicated and productive farmers to the wall.

Prior to Deregulation

Immediately prior to deregulation in 2000 the Victorian Dairy Industry Authority existed (VDIA) and for earlier history, see Appendix 4.

VDIA was a statutory Corporation independent of government and funded by the payment of $0.01 a litre on the sale of milk.

VDIA's role was to establish the sale price of liquid milk paid by the Processor to the dairy farmers. At the time it was about $0.45 a litre. Liquid or drinkable milk then represented about 9% of dairy farm output. The remaining manufactured products were unregulated and the farmers received about 50% of the drinkable milk price.

VDIA owned the brand names like Big M and Farm Gate which was used heavily in promotion. These had intrinsic value. My friend and colleague, Doug Weir, was the then CEO and insisted that rather than a private sale of $3M it should go for tender and $38M was received for these brand names. This $38M was set aside in a trust fund now worth $160M managed by The Gardiner Foundation. This has been used

to pay for education and research in the dairy industry. Each State had a separate authority, so it was a mess. VDIA encouraged deregulation but it must be remembered, at the time the retail oligopoly had nowhere near the power it has today. Those encouraging deregulation must not have foreseen the way supermarkets would exercise their power.

Today, a statutory authority is not the answer. Certainly not the one that hitherto existed. It only dealt with the relationship between the dairy farmer and the Processor for controlling the pricing of some of its product. The reality is, the real problem lies with the retail oligopoly and my suggested form of intervention is far superior, simpler, lower cost and far better for the dairy sector.

Deregulation Impact

Ten years or a decade is adequate time to determine the success or otherwise of the dairy deregulation. Although the problems have partly arisen with the failure of Murray Goulburn (MG), the structure is nevertheless unsatisfactory. With the failure of MG we now have three silos not two as exists in New Zealand. This as an aggregation gives the retailer more power. When the Processor and the farmers were one, the activity of processing and dairy farming was integrated and they stood as one when dealing with the retailers. It is accepted however that the failure of MG was poor management and board control and an expansion program that was way too aggressive. MG needed far more capital than the dairy farmers could contribute for this exposure so they lost power. The ego of the CEO of MG came before the interests of dairy farmers.

Corporate entities, particularly global ones, think and operate differently to cooperatives. The corporates must achieve a return on shareholder funds and they are under constant pressure to do so. There is a tendency, given quarterly reporting and pressure from the fund managers, to take short-term positions. The consequence is that corporates take decisions cooperatives might not. Cooperatives, where the Farmer and Processor are integrated can take a longer term and deeper view of the market. Also, at present there is pressure on corporates to look beyond the exclusivity of shareholder interest and consider the broader range of stakeholders. At this stage (except the Not-for-Profit), this is not

the law but it is where companies are trending. This trend has a long way to go before it would match the benefits of Dairy Farmer, Processor Cooperatives.

By compassion in the New Zealand, the government forced the amalgamation of a number of cooperatives before Fonterra was put in place. So, with an entity controlling 80%-85% of the market with the cooperatives consolidated, it meant there was a better chance of limiting the influence of external capital, which in the case of Fonterra, it was only 10% so the dairy farmers retained their control and influence. In hindsight it is clear that the demerging and failure of the cooperative movement in Australia has marginalised dairy farmers and there could have been a better way ahead. Without structural reform, which is extraordinarily difficult, some regulation is needed to ensure that unfair advantage is not taken in capturing too much of the rent.

Competition Policy

It is interesting to review the competition policy before deregulation took place in 2000. Rhonda Smith, an ACCC Commissioner, outlined the ACCC view that competition policy was part of microeconomic reform. This is all about:

- increasing output obtained from a given input (technical or production efficiency),
- improving the allocation of resources to those where consumers derive value (allocative efficiency), and
- improving response to changing demand and supply.

These are great words but when you look at what happened on competition policy and the deregulation of dairy that took place in the 2000, what happened is the exact antithesis of the objectives.

Whilst production efficiency may have improved this would have improved in any event and has not been induced by competition. With the allocation of resources, yes, the consumer has gained but the dairy industry is now in rapid decline. Processors are profitable, supermarkets are super profitable.

Deregulation did not recognise the reality and dynamics of the sector. Furthermore, the notion of public benefit enabling anti-competitive issues or structures to continue

which include:

- fostering business efficiency,
- industry rationalisation,
- expansion or employment,
- promoting industry cost savings,
- promoting competition in the industry,
- promoting equitable dealings in the market,
- development of import replacements,
- growth in export markets,
- arrangements to facilitate the smooth transition to deregulation.

On almost all of these scores the competition policy has failed to see the public benefit of some kind of regulation in the dairy sector. It is interesting that the wine / grape industry was unable to meet each year to talk about indicative prices. There was no concession made whatsoever for dairy farmers to meet and discuss pricing or what actions they might take to resist the onslaught of the Processors and the resellers. Competition policy actually weakened their position considerably and they did not have the benefit of having a union and be able to act as a union.

Many sectors of the economy, dairy has been the least understood by the so called competition experts and we are now left with a declining sector. The retail oligopoly is on top and calling the tune.

The ACCC Is Not Always Right

The ACCC and its forebears have a huge influence on the allocation of resources in the economy and when they get it wrong, it can have a profound effect.

One potential mistake was Dan Murphy (DM) where they did not understand the competitive dynamics. The writer, then Chairman of Woolworths (WOW) learnt on the grape vine that DM was for sale. Upon contacting DM himself, the writer was informed the ACCC did not want WOW to acquired DM and the ACCC were acting outside their statutory powers by seeking and encouraging another buyer to acquire DM.

To go to the ACCC for approval would have taken months and as DM's health was declining rapidly, this was not an option. My view was the transaction was pro-competitive and there was no way a court would intervene but this does not mean that the ACCC would not seek an immediate injunction which would push DM into selling to someone else.

The writer, with the endorsement of WOW CEO, put to DM the following transaction to acquire:

- WOW would accept the agreement as presented,
- the only due diligence would be limited to due diligence on the balance sheet and profit statement with DM's accountants,
- no site visits or discussion with employees,
- a signed unconditional agreement and a bank cheque for $26M would be delivered to DM by noon the following Friday,
- no discussion with ACCC.

DM agreed not to deal with the competing bidder and the ACCC accepted this proposal and emphasised that if WOW was a minute late the transaction would be over. WOW delivered.

At the time, DM had three stores with about $50 million in sales. It was marginally profitable. DM now has sales in excess of $4B, has hundreds of stores and has a 30% share of the Australian market. The DM format is a biggest of its kind in the world.

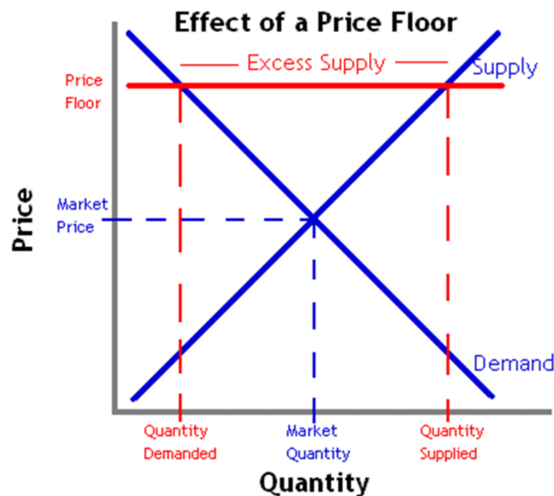
The ACCC was completely wrong forecasting behaviour that WOW would use its market power to increase prices. Indeed WOW intentions were quite the opposite to lower prices. As a result, Australian customers are hugely advantaged by the cheap liquor products they now purchase. The ACCC is not the only one not to understand competition dynamics so do some jurists.

The Academic Economist and the OECD

The academic economist argues in "Boundaries Economics – Introducing Supply and Demand and Government Intervention and the Equilibrium", where price floors

are discussed, that is a price above the so-called free market equilibrium price, is that more products will be produced and this increase will cause excess supply or a surplus and so disrupt the market.

Table 19: Effect of Price Floor



Here, the very opposite is true. Since deregulation in 2000 dairy farms, production, cows, employee numbers and capital have dropped dramatically to the point where Australia has an unprofitable sector and this will continue without intervention

No economic factor or lever has emerged that will self-correct the decline so endangering a once significant contributor to our agricultural sector including exports.

The reality is that it is the unconscionable and unfair price reductions have made the dairy sector uneconomic. Even a floor price of $1.50, including the $0.40 paid directly to the dairy farmer would only go some way to restoring the failure and damage.

By comparison with other products and world prices, an increase would not create any production surplus, which in any event, could be exported or used in other products. A $0.40 increase merely contributes some retrieval of fair pricing but does a great deal for farmer morale. So, the accounting theory does not apply here – page 12/77.

Smart Regulation

Smart Regulation – A Policy Statement by the Committee of Economic Development of the Conference Board September 20 2017.

This paper explains much of what has gone wrong with the 2000 deregulation. What is important with both regulation and deregulation is how to analyse and deal with it. These factors should occur:

- There should be significant industry failure,
- All alternatives should be analysed,
- Choose the regulatory action or inaction that maximises the net benefit for the community,
- Only engage where there is strong evidence on technical grounds,
- Understand the effect on different parts of the market,
- Respect everyone's property rights.

Clearly the net benefit referred to by the Hilmer Inquiry has not been properly analysed. The same issues apply whether you are regulating or deregulating.

The deregulation failed because insufficient notice was taken of the sector structure and the potential behaviour of the various participants and the potential business abuse arising out of the structure.

With regulation or deregulation, it should have come with:

- a sunset clause where the sector was reviewed,
- a clear statement of objective and potential outcomes,
- an annual monitoring mechanism,
- an understanding of the risks,
- a regime of proper information disclosure,
- rigorous reporting and transparency as to the effect of the deregulation or regulation.

In other words, we should have been a comprehensive statement of objectives so that performance could be measured and a willingness to review. There should have been better regulatory observation, enforcement and management.

The consequence is that we have seen a decline of the sector way beyond its base in the year 2000. Regulation or deregulation is not binary but there are in between situations like light or heavy regulation but wherever the position on the regulation or deregulation spectrum there should be a very clear statement of objectives so that outcomes could be measured. With information streaming through the problems of the dairy sector could have been dealt with a lot earlier.

If it is agreed that they should be further regulation limited to price regulation, we should follow the lessons of the past and the OECD recommendations. So there should be clear objectives with potential outcomes. There should be a monitoring mechanism, there should be information transparency and reporting and there should be a risk assessment undertaken.

Price regulation and monitoring does not involve:

- Regulatory complexity and vast rules,
- Adding bureaucratic cost which is out of all proportion to the benefits; it is an efficient mechanism with little ongoing maintenance and cost.

The economic uplift in the dairy sector will far and away be more than the regulatory burden of the Government intervention. This does not have the usual cost of a lot of other regularly interventions. It is simple, low cost and efficient.

Payroll Tax

Keating's solution to the current economic malaise is to supercharge the economy through the promotion of advanced technology. Keating was correctly looking outside the realm of monetary and fiscal policy.

Keating is right about supercharging through technology, but there is another way of achieving a super-charge. It is in the form of payroll tax reform, phased in over a five-year period. The Nationals ought to advocate for agricultural produce,

particularly those exported, to be ‘first cab off the rank’ in terms of payroll tax elimination. In this context the Nationals should recall the initiatives of leaders John ‘Black Jack’ McEwen and SAN (E)[1].

Other nations would not impose a payroll tax on agricultural production. Payroll tax reform may remove an important impediment to creating a margin of profit. This action is more palatable than outright protection through duties.

The Nationals find economic policies like the mooted regulation of prices in the dairy industry difficult because the Liberals control the legislative process and Treasury. Treasury is known to be arrogant and protective of its powers. It will often bully those with whom it disagrees. The reality is that Treasury controls the agenda and has many academic analysts and others to criticise the work of we mortals who concentrate on common sense not mathematical formulas. The Nationals will find that objections will be launched against their proposal in the bowels of Treasury.

In fairness to the Liberals there is a fear of anything that smacks of socialism; a banner for social and economic equality. Remember that Menzies won government by fighting Labor’s plan to nationalise the banks and this is seared in the soul of Liberals. But here there is market failure in its simplest form. It is not socialism to intervene and it is not difficult to articulate why there should be intervention. Menzies as a Liberal thinker would require this and act. See Appendix 5 on Menzies.

A lengthy paper on payroll tax is mentioned in the comment section at the end of this

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[1] The National party is in danger of losing too much of its identity with it being sidelined on too many issues important to the agricultural sector and regional Australia.

The National Party has been at best when its policy objectives have been clear and where the National Party has fought for these objectives.

There are times when the priorities of the Liberals understandably do not match the National’s so intense negotiation is required. To put a stake in the ground requires very strong leadership as we have seen in the past. In the days of the Fraser Government, Sinclair, Anthony and Nixon (SAN) acted in concert and in a very powerful way. They were fortunate in that Prime Minister Fraser was a farmer and would have empathy with the issues.

paper and is available upon request.

<u>A further comment on payroll tax:</u>

The Australian Financial Review (AFR) 5th January, page 21, "Tax Reform Urged to Energise Growth". This is typical and representative of the swelling demand for tax reform for:

- lower taxes,
- stamp duty to be replaced by land tax and
- higher GST.

The well-founded argument is that lower corporate taxes means:

- higher retained earnings,
- higher level of fixed capital investment,
- leads to higher level of demand for labour,
- means more payments to labour,
- more labour and payment mean more consumer demands,

and so a virtuous circle.

Lower taxes are fine but politically too difficult to achieve because of its differential effect. Some don't like foreign companies and the banks receiving any benefit.

The AFR article does not mention payroll tax.

In the current climate, where wages are stagnant, there is low unemployment and surprisingly no inflation is causing concern. So why in the current circumstances would you tax employment and inhibit:

- wage growth,
- more people employed,
- the exporters.

It is a State tax and an important source of revenue for the States. Its history is illogical and it has never made any sense. My paper deals with how to handle the issue that it is a State tax caught up in the State V Federal football match.

How to Regulate

The price regulator should make an assessment about which markets (conditions vary across Australia) require intervention, and what factors to take into account. For example, drought, feed costs, fuel etc. The price regulator should be flexible, evidence based, and its decisions open to input from farmers, Processors, retailers and consumers. The aim is to ensure that the financial rewards are shared equitably amongst the stake holders, and the sustainable survival of the industry as a whole. This is not socialism but intervening in an unfair, unconscionable and failed market; it is not the redistribution of goods and services as in socialism.

The price regulator should provide reasons for decisions, so that the market can adjust to these if necessary. It should also source detailed information and regularly provide updated reports to all about the state of the industry.

Where the regulator sets the benchmark and the extra amount (at least 40c) to pass through the Processor to the farmer and without deduction:

- The retailer should nevertheless be free to set its own price, but,
- The retailer should not be allowed to recoup any part of the increase out the Processors.

The regulator would avoid the recent situation where Coles did not pass the full 10c despite its public statement which were clearly misleading and deceptive.

The price regulator should report to the Agriculture Minister and not to Parliament, but provide an annual report to Parliament. It should be subject to a senate review yearly. Perhaps the authority should come under the auspices of the ACCC and thus gain the advantages of the powers that the ACCC derives under Competition Law or further powers given by the Government.

Processor Power

So far, we have concentrated on the power of the retail oligopoly where 3 players control well over 80% of the market. The 5 Processors control 82% of the market so the imbalance of power between the 5200 dairy farmers and the Processor is profound. Note that with the diminishing number of dairy farmers and dairy

cooperatives (only 5% of the market) dairy farmer power is further diminishing. The drought and bushfires only exacerbates the situation. For instance, Queensland dairy farm numbers have dropped in 2018/19 from 350 to 303 (13.5%). At this stage, the dairy farmer has not been authorised by the ACCC to join together to bargain on price and terms under the Exclusive Dealing Provisions of Section 47 of Competition Law.

Before deregulation the dairy farmers were negotiating by State. There were no reasons why this arrangement should not be renewed, whether it be by State or the Processors market and the Government should demand the ACCC analyse it.

This is Urgent

What needs to happen first is the price regulator should establish an average benchmark price for branded and unbranded milk and require the retailers to increase their net base price by at least 40c.

The extra price per litre should then be added to and paid to the Processor over and above what the Processor is receiving on the basis that it is paid and passed to, in full, to the dairy farmer, save, that they will be able to adjust price based on the protein / fat content for the individual farmer.

In passing through the price increase to the dairy farmer, the dairy farmers as a group must receive all of the increase only with adjustments to the farmer between protein and fat content.

In other words, the price increase of the base price flows through the Processor to the dairy farmer as if the Processor is merely a trustee.

Payroll tax ought to be phased out over a five-year period for all agricultural enterprises. This will make the industry more competitive and it will result in a boost to employment.

The Processors will welcome the government intervention because it gives them certainty, and it will mean that the retail oligopolies cannot access the increased margin. Hopefully Processors will, with better farmer economics, get increased

volume which always helps Processor profitability.

The Processor is still left with the problem that they need volume to cover their fixed costs. The retail oligopoly that takes advantage of the Processor by pushing the desperate Processors into winning contracts by lowering their tender prices. Thus, with lower prices, this flows through the supply chain to the disadvantage of the farmer.

The retail oligopolies should also welcome this intervention because they will avoid consumer anger with a level playing field. If they want to lower prices below the base and then increase it, it will be at their cost not the cost of the Processor.

The milk consumers will be happy that the dairy farmers are getting a fair go. They will happily pay more for their milk knowing that the farmers are receiving a fair price for their vital work in producing one of life's necessities.

The above recommended interventions may be executed quickly and economically. There is no reason whatsoever to delay government intervention. Action must be taken immediately to save the Australian dairy industry from its imminent collapse.

A Comparison of the Australian & New Zealand Dairy Industry:

Lessons to be Learnt

New Zealanders pay $2.51 per litre for drinkable milk which is 110% more expensive than Australian milk. Why? The New Zealand dairy industry is New Zealand's largest export industry being 25% of exports. The exports have grown 70% since 2001. The industry employs 40,000 people, the largest job creator in NZ.

Fonterra, the Processor, dominates the market. Fonterra is essentially a cooperative with outsiders merely having 10% of the shareholding. Fonterra is the largest company by revenue in New Zealand with revenue of $14.3 billion US and NZ market share of 82%. It is the 4th largest dairy company in the world. As well as being a cooperative, Fonterra is a listed company with 10,500 farmers having a

share through the Fonterra cooperative group which has about a 90% shareholding with the other 10% being listed. The valuation of both shares is the same. The modern Fonterra was formed in 2001 amalgamating most of the dairy competition.

The structure of the NZ dairy industry ensures that farm gate prices with dairy farmer control are maximised in line with export prices and domestic prices. The dominance of Fonterra, controlled by dairy farmers, ensures the dairy farmer is adequately compensated whereas in Australia, with deregulation in 2000, Australia is the lowest by an average of $0.50 per litre of all major consuming countries.

In comparing the country structures, it is clear that in Australia, dairy farmers share an economic cost as a loss leader for the benefit of the retail oligopoly. In Australia it is not only the retail oligopoly but the concentration of the Processors who have an arm's length relationship with dairy farmers. What is clear from NZ, is that the dairy farmers have considerable collective negotiating power and as the Processor and producer, this increases their power over the retailers. In NZ there is nowhere near the same retail concentration that there is in Australia.

The World Trade Organisation has under its rules, challenged NZ on why it should not be declared as anti-competitive. But does NZ care give its influence to the NZ economy?

In considering our suggestions as to a modest intervention in the market, Government should take notice of the starkly different situation in Australia and NZ. The upside of our intervention is that if we get behind our dairy industry as happens in NZ, with the opportunity of being able to develop a much larger export sector. We just simply need to increase the price of milk by $0.40 on top of the $1.29 per litre for the sole benefit of the dairy farmer to get the show on the road. This is why the recommendations by the Brumby Report become important in improving the overall effectiveness of the dairy sector.

With the premium price of milk in NZ, the consumer is enabling the dairy farmers to invest in innovation and growth. This has happened in spades. Not only are NZ dairy farmers very profitable, they have developed NZ's biggest export activity generating huge export income and strengthening its balance of trade.

NZ with its small economy and small geographic area, dairy farming as a small acre, not broad acre farming activity, means it is an efficient use of land and people. The climate, soil and ingenuity of New Zealanders also means it is good for the economy.

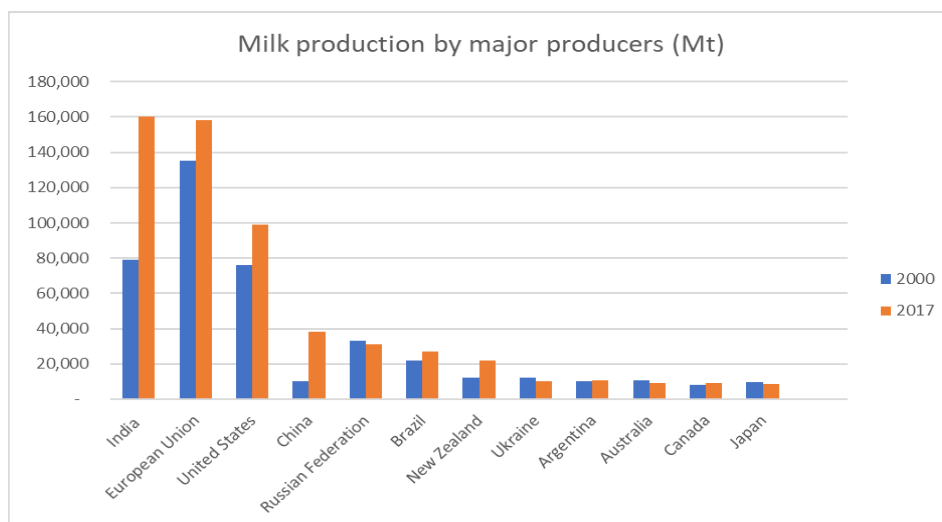
So far as the Australian economy is concerned, the premium paid by consumers pails into insignificance with the other benefits. The Hilmer Committee in Australia did not see this and their comments has lent to deregulation and the decline of the industry. There are pockets of Australia that can replicate NZ but we can never completely replicate NZ's success with dairy without significant Government intervention.

A Comparison of the Australian & Indian Dairy Industry:

Lessons to be Learnt

India have doubled their milk production from year 2000 to 2017 and claimed the number one position in the world milk production. India has achieved this with significant government intervention.

Table 20: World Main Milk Producers



India has traditionally been highly regulated. The government projects and programs in place for enhancing dairy development include subsidies for developing infrastructure for milk processing and testing. The Clean Milk Production Program is a centrally sponsored scheme that is being implemented by the State Department of Animal Husbandry, Dairying and Fisheries with several objectives:

i) the creation and strengthening of necessary infrastructure for the production of quality milk and milk products at the farm level up to the points of consumption;

ii) an improvement of milking techniques; and

iii) training to enhance awareness on the importance of hygienic milk production.

Several other rural development initiatives support dairying, such as through the District Rural Development Agency and women's self-help groups.

Currently in many states of India, the milk price is set by the cooperatives; this is used by all other players, typically by paying 10% more than the cooperative price. Where dairy farmer organizations are strong, farmer prices are higher.

Cooperatives are the central players in a three-tier structure:

i) primary societies at the village level,
ii) unions at the district level, and
iii) federations at the state level.

Currently, there are 14 federations in India.

In most other states, the cooperatives are managed by civil servants, function more as government bodies and are weak representatives of farmers.

Of the 14 major state cooperatives in the country, 10 have state government equity, of which 6 have government equity in excess of 51 percent. Twelve of the 14 cooperatives have government officers as managing directors who are State appointed. It is not uncommon for these officials to change up to three times a year. Because of such governance, cooperatives are mere parastatals and do not work in the true spirit of cooperatives – with elected farmer representatives and professionals who run the organization. This governance structure influences the functioning of the entire chain, from the state to the village societies and thus significantly impacts farmers' involvement in the chain.

For most of the private dairies, agents procure the milk from farmers. Some private dairies have established village societies for milk collection that follow the cooperative model. However, this model requires much larger investment and is not

economically feasible, considering that cooperatives receive considerable development support from the government (such as feed subsidies). It is not uncommon for private dairies to make loans to farmers, which is a key reason for the somewhat large share of milk directed to this channel.

Animal health and breeding services provision, veterinary infrastructure development and vaccinations are the responsibility of the state government. These services have traditionally been provided for free or at a very subsidized rate. In the past few years, there has been increasing awareness that the state pays heavily to offer these services, which are easily available to farmers. Consequently, many states have instituted partial or full-cost recovery fees for providing the services.

In addition to the State Department of Animal Husbandry, Dairying and Fisheries, the milk co-operatives and NGOs (BAIF, JK Trust) provide services in many states. So, do trained private sector AI technicians, although for a fee. As well, state livestock development agencies are being set up as autonomous bodies to offer services in animal breeding in the form of procurement, production and distribution of breeding inputs (such as semen and liquid nitrogen), training and promotional activities.

Concentrates used for fodder include coarse grains, such as maize, sorghum, pearl and other millets, and other cereal by-products, such as rice bran/polish and various oil meals, including groundnut cake, mustard cake, coconut cake, soybean meal, cotton seed meal and sesame cake. The escalating price of feed ingredients is a major cause for concern. In many states, cooperatives are involved in producing feed concentrate and selling to farmers at subsidized rates.

In summary: The significant market intervention includes:

- Policy favouring expansion of cooperatives managed by Public Administrative Servants, thus disfavouring the private sector.
- Cooperatives ultimately Government price setting, hence limits prices been set by market forces.
- Government subsidies for animal health and breeding services, bulk chilling, processing infrastructure.
- Recently in the Regional Cooperative Economic Partnership negotiations the

Indian Government in not providing access for Indian Dairy market to International competition.

- Government set ambitious national dairy production targets of 300 million tons by 2024.

The Australian Dairy Plan Report 2019

(Released 6 December 2019)

The above Draft Plan (with detailed Appendices) prepared and led by John Brumby is helpful. It is now up for discussion and comment. This work is not binary and in most respects is complimentary to and reinforces our work.

In preparing our material which commenced in November 2019 we learnt the following:

- it has been very difficult to glean information. It is in many places with no one source,
- there are too many dairy organisations. These need to be consolidated and lead,
- with the 5213 dairy farms there is a mix of size, competence and geographical limitations,
- the 2000 de-regulation has, despite the short-term levy, failed and the Murray Goulburn situation has been a disaster,
- dairy farmer morale is low, distressed and frustrated by no dairy plan or any integrated policy and pricing intervention by government,
- **the Brumby Report underpins the need for pricing intervention confirmed by research and in discussion groups. It is at the top of dairy farmers concerns,**
- farmers recognise that the distribution of power in the supply chain is unfair and unconscionable,
- farmers have far less leverage than Processors and the retail oligopoly,
- farmers are not good at articulating the issues and pushing their cause,
- farmers lack a unified voice in Government and industry affairs.

To reiterate, the Brumby Report is complementary and we both conclude Government must intervene with the pricing of milk at supermarkets. There should be a pricing regulator and price monitoring. It is difficult to get information out of the industry. This is vital for better decision making.

The objective of putting information into the marketplace so that dairy farmers and the public can see the issues and the evidence will help the morale but will not solve the problem. This only recognises their plight. Consumers are on their side. Nothing will happen unless there in intervention now.

Price monitoring alone is unlikely to contain retailer oligopoly power. The intervention by Government with petrol price monitoring failed. Just putting information into the marketplace has not significantly impacted the power imbalance. Petrol monitoring is not giving the consumers any significant improvement in price. Just watch the pre-Xmas price of petrol that will bear no relationship with the wholesale market but where there is huge traffic and profit opportunity.

By comparison with other countries, Australian dairy is the least subsidised and supported (second to NZ). Farmers are subject to rigorous market conditions far more than elsewhere save China where it is difficult to understand the dynamics.

The Government has intervened in the electricity market and as from July 2019 the retailer must disclose three benchmarks, define market offer, standing offer and default market offer. It is too early to see how this will work but it is interesting that the Government is also trying to legislate, giving the ACCC power to intervene and force divestment if established the players are manipulating capacity to influence demand.

But with the January announcement by Origin and AGL (the energy oligopoly) of price increases, Origin says the average residential customer's power bill will increase by $122. AGL will increase by 5%.

The default price will increase be $110 for households and on average $465 for small business.

So the Code of Conduct which was meant to deal with so-called loyalty tax is not working where long standing loyal customers are meant not to be disadvantaged. The reality is that you need more power to solve this problem.

It would be helpful to understand overseas practice to ensure optimum nature of intervention. Intervention in the agricultural market generally is anathema for

Government because Governments believe the Australian agricultural free market has been good forcing innovation and efficiency. But with dairy, this is only part of the problem. It is possible that as more dairy farmers improve efficiency and lower costs, the Processors and more importantly the retail oligopoly, will capture too much of the efficiency rent.

This report supports the long- and medium-term plans of the Brumby Australian Dairy Farm Plan arising from its objectives of:

- profitability across the supply chain,
- rebuilding the confidence,
- uniting the industry by rationalising the way the industry is organised,
- establishing a united and powerful voice.

Further work by the proposed Joint Transition Team (JTT) will delay the benefits. The Government should commence regulation now. It will take time for the other reports to be considered final recommendations made and the implementation plans designed and undertaken.

The risk is that the Brumby Report (which embraces the National Farmers Federation (NFF) 2030 Road Map released in 2018) will cause delays and be seen to be a solution which it is not. These plans are medium to long term as indicated in the NFF 2030 Roadmap Report.

The Brumby Appendix on Stakeholder Engagement, there is an imbalance of power in the market and price regulation is the solution, although there is some discussion about a dairy pool, but the latter would take time to implement. The stakeholder and committee conclusions align with this report. The detailed information like the breakup in the mix of farms and the fact that farmers are getting a low return, for their levy to fund advocacy is helpful. Stakeholders are aware that consumers will be willing players in any form of price regulation.

As with immediate price regulation, Government support, as recommended by the Brumby short- and long-term plans, will deliver massive growth and benefit the economy. So, Government cooperation as exists in almost all other countries, is critical.

The argument that the cost pressures on the industry have led to inefficiency and innovation are correct but this price / cost squeeze has already eliminated many poor performers. Those that remain should get price increases to stop further exits.

Our focus has been on the immediate-term. A crisis which requires immediate intervention. For every month of delay the sector and the committee in which they operate is being severely damaged, both emotionally and financially, not just by farmers exiting but the continual deterioration in morale. It is unconscionable and un-Australian. It would be a shame that the many Brumby draft recommendations that require implementation should delay immediate price regulation. Brumby would not want that.

By immediately regulating and solving short-term problems greater effort can go into implementing the medium to long-term changes and avoiding the "current drift and the decline" identified by the Brumby Report. To delay is not in the interests of the dairy farmer.

Immediate price regulation will give huge encouragement and boost the morale of dairy farmers with very little cost to the consumer. You cannot underestimate the benefit of the morale boost and the consequent enthusiasm for introducing the rest of the medium to long term recommendations. Expectations will be enhanced and dairy farmers will hold on and work with Brumby on the next stage with enthusiasm and optimism.

This independent, voluntarily prepared paper (without reward and sponsor) agrees with the Brumby Report and particularly with stakeholder observations. You can understand the architect of Brumby reports seeking feedback and even more detailed plans. That is professional but will not meet the expectations of the pragmatic farmers who are likely to say, 'here we go again, another report, another set of recommendations, and more delays, but when and will the Government ever act?' Our report also deals with the philosophical issue of when and how you should intervene. **Our work makes the case for strong intervention now.**

John Brumby, in an interview with ABC News, indicated that the dairy industry poses complex problems requiring complex answers:

> *"There's no silver bullet, there's no magic bullet that's suddenly going to fix this industry. It's going to take a carefully put together plan to take the industry forward. But, you know, the alternative for our regional economies and for Australia is not worth contemplating."*

I agree with John Brumby's medium to longer term view but there is a short-term silver bullet that can make a dramatic, short term impact on the dairy sector. It can be implemented in weeks and the dairy farmers benefit within weeks. This should help to abate their rapid decline in the sector. Unfortunately, there may not be much of a sector left if we wait for an outcome to Brumby's medium to long term plans. The immediate silver bullet might keep the sector in place to enable the medium to longer term planning.

The Brumby Inquiry will keep the protagonists at bay and slow down the lobbyists wearing out the floors and corridors of parliament. In any event, an inquiry will establish the legitimacy or otherwise of the complainant's case. Inquiries often muddy the water and the complainants can put their anxieties to the inquiry. Don't worry, there are only 5213 farms and they are spread over the regions, are disparate and invisible. Their voting intentions are unlikely to change. The work on energy reform is far more visible, more votes and vote changing.

Postscript

The Australian Dairy Plan Committee Chairman, John Brumby is recommending a new entity, which in addition to having dairy farm directors, would have representatives from the Processors in particular, Fonterra, Saputo and Lion / Mengniu. The basis of this recommendation is that it is important to represent the whole dairy supply chain and produce integrated plans for the chain. It suggested that issues of conflict between the dairy farmer and Processor on such things as pricing can be handled. This is naïve. The difficulty about the whole dairy sector is the imbalance of power between the retailers and the processors and the processes and the dairy farmers. The dairy farmers have very little power. An integrated committee reduces their power. The farmers need to have their own entity. If the Committee were to pursue a model like this, why not have dairy farmers on the boards of the Processors and the Retailers?

Many of the problems in sector can be resolved by addressing this power imbalance and give the dairy farmer more power in the chain to achieve their objectives. Without achieving that power the dairy sector will continue to decline with the rate likely to be exacerbated with the drought and fires.

Australian Dairy Farmers Limited (ADF)

The submission by Australian Dairy Farmers Limited (ADF) into the performance of the dairy industry since de-regulation since 2000 has some very important observations. Page 49 of the ADF submission lists all of the inquiries and reviews that have taken place including the work of the Senate Economics Reference Committee. It is incredible the amount of time, cost and involvement of numerous people to solve the problem but after 10 years, there is no solution and, in the meantime, the dairy sector has steadily declined in size and performance.

It is a shame that a once very healthy sector, as an important part of our agricultural mix, has suffered as have the dairy farmer's morale, emotional strength and livelihood. Dairy farmers are simply lost for words. With their very weak position in the supply chain they are relatively defenseless. How can Australian let this happen? It is not in the interest of the economy, let alone our dairy farmers. No other country would allow this to happen.

Whilst there are only relatively small pockets of Australia that can replicate the NZ success story, very simple measure can be taken to reverse the fortune of our dairy farmers and put them on a path to success. No more reports, nor inquiries are needed. It simply means the intervention now by The National Party. This should be a core issue for the National Party. The National Party should put a stake in the ground and demand of the Liberals, immediate action. It should be a fundamental part of The Nationals relationship with the Liberals. This is so important that it should threaten the Coalition Agreement. This should not be put into the process of Government and rank below other coalition priorities.

The National Party needs this to reinforce their role as a natural representative of the farmer. In any event, there are huge opportunities for the economy and the Liberals as a whole should not have any difficulty with this.

The Australian Dairy Farmers Limited (ADF) Submission:

'The Australian Dairy Industry and Profitability Since 2000'

This submission has a different focus to that of the Brumby Report. In the main, it is complementary with our material, save in several areas, which in reality are a matter of opinion.

The great benefit of the ADF Report is that it analyses what has happened since deregulation in 2000 and compared this with other countries like New Zealand and India where New Zealand and India's competitive position has increased and ours has declined. This was measured in 1990 when export dairy products were 16% of the agricultural exports as compared to 6% today. This is against a background of solid increases in global trade.

This is an alarming statistic and must be of great concern to Government not only because of the Governments lack of intervention to help the dairy farmers, but because of the significant loss to the economy. The reasons for this decline are well known and articulated elsewhere within but it is worth reinforcing the decision of Coles to commence an aggressive campaign has caused much damage.

As articulated elsewhere and within, there have been a huge number of reports and analysis done but the fundamental problem has still not been resolved. The ADF Report highlights the attempts by Honourable Bob Katter and Pauline Hanson on three occasions to attempt to get some cut through and save the dairy industry from failure. It is regrettable these initiatives failed although this is probably because of inadequate information in the marketplace as evidenced in our material and there is a better way of achieving their objectives. The ADF Report makes it clear that milk should be sold at $1.50 per litre.

Page 14 onward of the ADF Report lays out the structure of the dairy industry policy, advocacy and research activity. What must be said is that with the funds being made available there should be an opportunity to improve the effectiveness of this organisation. This should be the subject of a separate study.

One issue where we are concerned, is the conclusion reached by the Hilmer Competition Review of National Competition Policy Agreement (1993) was, that in effect, dairy should be deregulated on the basis that the regulation did not meet the public benefit test.

We would now say that judgement was wrong and that the deregulation has led to the decline and potential failure of the dairy industry because the Hilmer Review did not understand the reality and structure of the marketplace and the power of the Processors and retailers to achieve their own goals to the detriment of the dairy farmers.

The work done by the Dairy Farmer Monitor Project has been very valuable and the report contains some very good evidence. One being that a flatter production cycle with all year-round production has reduced Australia's domestic and international competitiveness. The report also highlights the extent to which the sector in other countries is protected and subsidised by Government which disadvantages our dairy farmers in the export market.

The consequence of deregulation is that New Zealand, the EU and the US have overtaken Australia as the dominant exporter with New Zealand being 40%, EU 20% and US 14%. NZ has improved this position dramatically. India does not export although it is the largest world producer. This is needed for their own consumption because of their huge population (1.3B).

As we identified, smaller farmers have left the industry because the land, labour and capital inputs have shifted towards the larger more efficient farmers which is not a bad provided there are reasonable and fair transition arrangements for the smaller farmer. The ADF Report agrees with our conclusion that while farm gate prices have increased, these have been absorbed by higher costs so there has been a significant income / cost squeeze.

One interesting observation is that freight costs have increased considerably as Processors use B-doubles and shift milk from more distant places to save Processors from having to support some local farmers. As a result, farmers have incurred extra cost to improve farm storage capacity and rapid milk cooling facilities at the request of Processors with less deliveries to each farm. These economics

obviously help the Processor over the dairy farmer and is another example of how power has been used to the disadvantage of the dairy farmer.

Page 46 of the ADF Report notes that Australian farms achieve considerably less on average return on equity than farmers in the US and UK and probably NZ.

Page 49 of the ADF Submission deals with the steps taken to improve dairy farmer performance but again this does not solve the poor and unfair industry structure and the lack of dairy farmer power. We depart from the Report in terms of market failure being mainly a lack of information. We believe dairy farmers are losing due to unfair Government policy and competition strategic issue not a lack of updates / information. The lack of information has to do with the layering process.

Finally, the ADF Report acknowledges that it has been inappropriate pricing by Australia's major supermarkets. We disagree with the Report's observation that introducing any form of price control is inconsistent with Government initiatives and undermines Australia's international trade obligations and the Australian Constitution. We believe this is naive and misunderstands the fundamental problem whilst a lack of information is a minor element only when in reality it is structure.

In fact, ADF Report agrees with our thinking and may contradict itself on page 59 where it suggests that home brand retail fresh milk price to be fixed to $1.50 per litre with increase (50 cents per litre based on the original $1 litre milk) going back to dairy farmer via their Processors and agrees with my recommendations of short term solution to increase home brand retail milk price to stop farmers hardship and farm exit.

We also have a material disagreement with the ADF Report in respect to the role and effectiveness of dairy codes. The dairy codes will only solve a limited number of issues and it does not deal with the fundamental issue of structure failure. We have dealt with that issue extensively. The ADF Report observes that the process is pushing for all year-round production as to supply more of the domestic and the international market has materially increased farmers production costs without reward.

The ADF Report deals with the temporary $0.10 a litre increase and why this is ineffective. One issue according to ADF, is trust, will the retailers pass through the $0.10 to the farmers. Coles' failure to do this has caused a lack of trust which dairy farmers are opposed to.

It was Coles who started the $1.00 milk campaign which led to the discounting of all drinkable milk in the market. Many at the time were concerned and perplexed knowing the Coles competitors will follow and the discount will be universal. Coles would receive only a minor tick from some consumers for taking this lead. Any competitive advantage was momentary and limited. Coles was trying to make a statement about its competitive pricing because of the public perception.

So, when Coles attempted to address the damage by publically stating a 10% increase for the exclusive benefit of the farmer and then not delivering on this promise Coles has done great damage to its integrity and reputation with the dairy farmer. Not only have Coles failed to gain competitive advantage, they have damaged themselves and caused untold problems for the dairy farmer.

<u>We believe our solution to the way price is regulated, will deal direct to the dairy farmer, and money available to farmers by going to $1.70 per litre with an increase of $0.40 will have a material impact on the profitability of farmers enabling them to serve, invest and innovate now.</u>

The ADF Report regrets Coles was not prosecuted for very serious, misleading and deceptive conduct in a way that would be upset many Australian consumers. We agree.

When considering a substantial Government dairy farmer support package, this money could be best spent by paying for the cost of a price regulator.

The observations in the ADF Submission in respect to productivity with the more research etc. is excellent and should be followed.

<u>Appendix 6</u> sets out a suggested statement for consideration. Note that it anticipates the cooperation of the supermarkets. The supermarkets should agree to make a $0.40 payment forthwith to the dairy farmers before understanding the details of any

regulation. To delay until regulation is put in place is dangerous and the Prime Minister should be able to achieve the cooperation of the CEO's of Woolworths, Coles and Aldi in anticipation of the regulation being passed.

APPENDIX 1: The Nutritional Profile of Milk is Impressive

The Health Benefits of Milk:

- Milk is an indispensable food as it is plentiful, always available, inexpensive and very nutritious being an excellent source of **protein**, **fat**, vitamins and minerals.

- One cup of milk contains 8 grams of protein. **Protein** is necessary for many vital functions in the body, including growth and development, cellular repair and immune system regulation. Milk is considered a "complete protein," meaning it contains all nine of the essential amino acids necessary for your body to function at an optimal level.

- 100 g of whole milk carries 64 calories, 3.66 g fats and 3.28 g of protein.

- Milk is rich source of **calcium**; 100 g of fresh milk contains 119 mg. Calcium it provides ensures proper **teeth** development, acts on the functioning of the heart cells, **nerves** and **muscles**, encourages **bone** growth and plays a role in the prevention of osteoporosis, hypertension and, possibly, colorectal cancer and hypercholesterolemia.

- It is a good source of B-complex vitamins such as riboflavin, vitamin-B12, magnesium and Zinc.

- Apart from calcium, it contains healthy amounts of phosphorus (93 mg) and potassium (151 mg), and a moderate amount of sodium (49 mg).

- Natural grass-fed cow's milk is a rich source of vitamin-A and β-carotene. β-carotene is the pigment responsible for the yellow colour of milk, more noticeable in butter.

- It is, furthermore, considered that for the overall population, there is a greater risk of calcium, riboflavin, vitamin-D (in fortified milk) and Vitamin B12 deficiencies if dairy products, particularly milk nutrition, are not part of the daily diet.

- Drinking milk is associated with a lower risk of age-related muscle loss in several

studies. In fact, higher consumption of milk and milk products has been linked to greater **whole-body muscle mass and better physical performance in older adults.**

Science Daily:

To Gain Muscle and Lose Fat, Drink Milk, Study Suggests

August 9, 2007 McMaster University

Summary: Milk helps exercise buffs burn fat. In a recent study, the milk drinking group came out on top in terms of muscle gain with an estimated 40% or 2.5 pounds more muscle mass than the soy beverage drinkers. In addition, this group gained 63% or 3.3 pounds, more muscle mass than the carbohydrate beverage drinkers.

Chocolate Milk Could be Key to Longer, healthier Life

March 2, 2006 University of Auckland

Summary: The popular saying goes that 70 is the new 60 and 60 is the new 50. Unfortunately for much of New Zealand's aging population declining muscle function means it simply isn't true. New research however from The University of Auckland's Faculty of Science aims to develop a non-pharmaceutical means to maintain muscle function and quality of life in older individuals. The good news is the answer could be as simple as taking a stroll followed by a glass of chocolate milk.

Milk is Better than Water to Rehydrate Kids, Study Finds

August 23, 2011 McMaster University

Summary: Children become dehydrated during exercise, and it's important they get enough fluids, particularly before going into a second round of a game. A new study by researchers in Canada found that milk is better than either a sports drink or water because it is a source of high-quality protein, carbohydrates, calcium and electrolytes.

APPENDIX 2: Milk Processing

Milk processing is complex, capital intensive and requires great control because of the health risks. All Victorian Processors are audited by the statutory body, Dairy Food Safety Victoria (DFSV) for adherence to strict safety standards.

Milk Receivable

On arrival, milk is immediately tested for antibiotics to confirm the absence of penicillin before being transferred to silos using load-in pumps with inline filtering systems. To ensure the highest standards of cleanliness and hygiene are met, silos are washed daily with Cleaning in Place (CIP) equipment.

A valve cluster and pump then distributes milk to either whole milk or standardised milk silos for processing.

Separation

Whole milk goes to a balance tank where a plate heat exchanger raises the temperature to around 16 degrees. Cold bowl separators then use centrifugal force to separate the in-feed into cream and skim milk.

This low heat treatment during separation ensures a low microbiological count and the dairy flavour is maintained through to the finished product.

Food Preparation

Once separated, fresh cream is held in storage ready for immediate processing and blending into a range of products including frozen cream, natural cheese and milk concentrates.

These products are packaged in "bag-in-box", placed in an on-site freezer and frozen to -5° within 24 hours.

Boxes are palletised and transported to a cold storage facility and prepared for dispatch.

APPENDIX 3: The Economics of Farming

Farmers are essentially price takers not makers:

- there is an expected price,
- a variation to this price, up or down, depends upon:
  - the product quality (differentiated between producers),
  - the timing of the product to market.

A Farmer's revenue is less predictable than Main St and varies upon factors outside their control (like climate change) but depend upon:

Scale and Productivity.

Over the years, farmer's revenue per unit sold has not grown anywhere near the same as their costs. So there is a price / income squeeze and there appears to be no respite.

Unlike Main Street, a higher proportion of the farmers costs are fixed or semi-fixed which means they cannot influence these costs in the short term:

- property costs (mainly fixed),
- transport (semi-fixed),
- plant equipment (semi-fixed).

There are few variable costs which influence revenue.

Farmer's property:

- costs are a greater portion of their assets than is the cost of stock,
- greater than Main St as a proportion of the asset,
- has been in the family for generations often with the wider family involved,
- relocation is difficult,
- cause inflexibility,
- huge cost of rates against book cost.

Farmers:

- can influence the stock holding relatively easily by the sale, purchase or breeding but the difficulty is that price is heavily influenced by the timing of the sale,
- suffer from the tyranny of distance which has a greater inherent cost of transport than Main St,
- The alarming rate of farmer deaths, suicide, and short life expectancy.

There is a higher inherent risk in farming from fire, floods, drought, OHS and farmers have more assets and risks to cover than Main Street and so is more expensive.

Indeed some risks cannot be insured eg. flood in some areas or alternatively you pay a much higher premium.

Main St is a much more flexible than farms because:

- usually businesses have five-year leases so at the end of that time they can change or relocate,
- businesses can manage their wage cost more flexibly.

Scale is important in any business as it enables you to fractionalise your fixed and semi-fixed costs. With scale comes:

- volume and
- incremental economics increases profit.

Yet scale is more difficult for farmers to achieve because of the:

- limits of their landholding,
- availability of land nearby which only occasionally comes up for sale.

There is real advantages for large-scale farmers but this opportunity is limited to a few. In East Gippsland we have few large-scale landholders that have the benefit of scale and the consequence is:

- the advantages of economics,
- being more productive.

Some farmer benefits come from being on the land, but for many, this is their own labour and the tax issues are marginal. This benefit is less than the tyranny of distance.

The difference between farmers, large and small scale, is considerable and for the small scale, the economics are questionable and when on the edge, means that

droughts and floods are a disaster.

A farmer spends a high proportion of his time on his farm. This has both advantages and disadvantages:

- in times if distress, the work environment reinforces the grief,
- with the farm as your home there is less opportunity do other things and find balance in their lives,
- it makes contact with others more difficult,
- Decision making becomes more difficult,
- Leads to greater anxiety and the stigma of mental health risks,
- requires extraordinary:
    - fortitude,
    - hard work at all hours,
    - family involvement,
    - Unpredictable demands.

Governments have to intervene and we as a community must also help.

One interesting side observation is that there is a very close linkage between the farmer and their local community. As an example, a dairy farmer, on average, reinvests or spends approximately 80% of their income back into their local community.

APPENDIX 4: Industry Deregulation

Much of the current dairy industry circumstances have developed from a number of very significant policy and trade decisions taken by state and federal governments over the past 50 years. These include relinquishing access to EU butter in the 1970s, Australia/New Zealand Closer Economic Agreement (CER) with NZ in 1980s and National Competition Policy of the 1990s. **Deregulation of the dairy industry in 2000 is simply an extension of these events**.

In the late 1960s and early 1970s the Australian and NZ governments negotiated with the United Kingdom (UK) and European Economic Community (EEC) for dairy product access into Europe. This was a significant milestone as Australia's milk production for the last century was based on seasonal milk production to produce cream to make butter for export to the UK. The negotiations between the four governments resulted in Australia losing virtually all of its butter access while NZ kept most of their access after the UK entered the EEC in 1973. This decision agreed by the Australian Government prior to 1973 meant Australia had no immediate home to send its butter, resulting in what can only be described as a crash in domestic milk production.

During this period state governments regulated volume and price for liquid milk production, processing and consumption to ensure there was a supply of milk for consumers all year round. The industry crash of the 1970s meant there was significant pressure for all dairy farmers in a state to share in access to the fluid milk markets within each state. There were milk wars in each state with farmers outside fluid milk zones denied access to the major capital city higher value/priced milk markets.

Each state government in the mid-1970s took action to address the fluid milk access arrangements. New South Wales, Queensland and Western Australia redistributed quota/entitlement for fluid milk production to farmers throughout their state. This meant all dairy farmers in these states had to produce milk all year round. The quotas had a value attached to them to allow trade between farmers. In Victoria access to the fluid milk market was designed in a different way. Here dairy

farmers were paid the regulated higher liquid milk price for a percentage of their milk each month. This fluid milk payment system meant dairy farmers did not have to produce milk all year round to have access to the higher value fluid milk market.

Throughout the 1980s and 1990s New South Wales and Queensland processors remained relatively competitive against Victorian manufacturing milk products such as cheeses, etc. This is due to farmers being paid a lower price for their milk (lower than world market prices). **Northern farmers** were able to make solid margins because of higher fluid milk volume per farm and the price paid for milk being above marginal cost of production. **The seasonal milk production system, which continued in Victoria, meant there was a lower cost of production to allow lower costs to processors for manufacturing milk products like cheese, butter, and skim and whole milk powders.** In addition, processors had more certainty of manufacturing milk volumes in Victoria versus the marginal nature of such milk production in New South Wales and Queensland.

This also explains why milk production for manufactured milk products moved to southern Australia throughout the 1980s and 1990s – to access lower production costs of seasonal milk supply. It was seasonal milk production which gave all states a competitive advantage in exporting butter to the UK up to the 1970s. This continued seasonal production was the trigger for southern Australia to maintain competitiveness for exports over the past 40 years.

The CER came into operation in 1984. Australian dairy was able to negotiate a 10-year phasing in of NZ dairy exports to Australia. This provided the industry time to improve productivity. Up until this point Australia had a wide range of tariff barriers and export support arrangements for manufactured dairy products. This decision by the Australian Government to open up the economy to greater competition was the beginning of deregulation and industry adjustment.

There were several key policies implemented shortly after the CER to further open up the Australian economy. The Kerin Plan of 1986 and subsequent Crean Plan of 1992 were designed to see all domestic and export support arrangements for manufacturing milk products removed by no later than 30 June 2000. In the 1990s the bipartisan (state and federal governments) National Competition Policy (NCP)

Agreement, which arose from the Hilmer Review of NCP was implemented. This required all jurisdictions to review their regulations, including pricing and supply regulations, based on a public benefit test. If the review concluded that for a particular regulation, there was a negative public benefit, the relevant jurisdiction was required to remove the regulation. This included review of fluid milk arrangements in each jurisdiction. Each state, with the exception of Victoria, found a positive public benefit to retain pricing and supply regulations. Consequently Victoria, under the terms of the NCP Agreement, was obliged to remove their fluid milk pricing and supply arrangements. With the Australian constitution allowing free trade between states, the Victorian decision meant all state fluid milk pricing and supply arrangements are no longer valid.

These events provided the catalyst for the industry – farmers and processors – and governments to work together to formulate a united national dairy plan. The primary purpose of this work was to have state fluid milk supply and pricing arrangements removed by 1 July 2000 and for the Australian Government to implement an appropriate transition package. Led by the ADIC this resulted in the *Dairy Industry Adjustment Act 2000 (Cwlth)* in April 2000, where the Dairy Adjustment Authority (DAA) administered applications for assistance from dairy farmers under the Dairy Structural Adjustment Program (DSAP) Scheme. In July 2001, the *Dairy Produce Legislation Amendment (Supplementary Assistance) Act 2001 (Cwlth)*, provided the legislative framework for the DAA to administer additional assistance measures to dairy producers under the Supplementary Dairy Assistance Scheme. During the period of implementation (2000 to 2008) the DAA committed $1.6b under the DSAP and $111m under the Supplementary Dairy Assistance Scheme.

(Source: Australian Dairy Farmers)

APPENDIX 5: Sir Robert Menzies

Menzies came from a middle-class family who were neither rich nor poor, advantaged or disadvantaged. His future depended upon his own ambition and wit. Winning a scholarship set him on the course for great leadership success. Menzies never forgot the benefit of education and he did more than any other leader helped the university sector in increasing funding and establishing the Commonwealth Scholarship Scheme.

Menzies always remembered his middle-class background. He was very careful to keep his government in the middle, avoiding the extremes of the left and right. As far as the right, he kept his distance from big business and placed limits on the growth of The Herald and Weekly Times empire and unlike many of his predecessors, he kept his distance from the media, particularly Sir Keith Murdoch. On the left he fought communism and the nationalisation of our banks.

He was so successful with his focus on middle-class values, attitudes and aspirational values. As a jurist he had a great sense of fairness and justice. He also was a surprisingly good administrator. With his considerable intellectual and persuasive powers as an orator he was able to see through many of the fads of the time which in today's terms, we would call ‘popular-ism’ and identity politics. He was able to use his great intelligence to articulate the dangers of these kind of influences.

Menzies was a small ‘L’ Liberal and he would have a natural empathy for the problem of our dairy farmers and he would find ways of solving their problems. He would see their problems as unconscionable and unfair and something that the average Australian would not like.

It is a curious position we are in with our dairy farmers because there is no doubt the average Australian would see the fairness of paying another $0.40 per litre for their milk for the benefit of the dairy farmer exclusively. Menzies had great confidence in the intelligence and decency of the average Australian and it is for this reason many of his policies were sound and so successful.

APPENDIX 6: Statement on the Dairy Sector

The price of drinkable milk in our supermarkets is by far the cheapest in the world. This extremely low price has damaged dairy farmers many of whom are struggling to survive or have failed. The bushfire crisis has exacerbated this as many dairy farm areas have been ravaged. We now have a sector in rapid decline with great humanitarian issues.

It is in the interest of the dairy sector and our economy and a sense of fairness that the Government should intervene and require the supermarkets to make a payment of $0.40 a litre, passed through the Processors without deduction, to the dairy farmer. It will be open to supermarkets to increase the price of an unbranded milk from a $1.29 to $1.69, or whether they absorb some of that increase. It is this standard discount price (SDP) that is placing great pressure on the dairy farmer and the dairy supply chain. The Government is not attempting to regulate supermarket pricing for the consumer, it is up to the supermarkets.

The Government wants this Farmer's Fair Adjustment Amount (FFAA) to commence for milk sold from the 1st of the next month so the dairy farmers can get immediate relief. This will be timely with the problems in rural Australia with Australia's worst ever drought and now bush fires where many dairy farmers have been directly affected.

The Government will seek to put in place a regulatory regime through the ACCC to monitor the situation. The regulator will be asked to inform the public of the implications of a FFAA and its implications in the dairy supply chain. The Government would require the ACCC to state its reasons for the annual FFAA. Even if the supermarkets elected to increase the price of milk to $1.70 it would comfortably still be one of the cheapest in the world but there are issues with fluctuations.

The regulator would be asked in April each year to make a recommendation to the Minister for Agriculture as to what the FFAA should be for the ensuing year. The first occasion for this will be in April 2021 so that the regulator, on reporting to the Minister can allow the public a month to comment on the recommendations so that

the FFAA can apply for the year commencing 1 July 2021. It is important that the adjustment take place immediately as dairy farmers are failing at the rate of 2 to 3 a week. With the current bush fires, this is likely to be much greater.

The ACCC will also be requested to allow dairy farmers to negotiate pricing and terms with the Processors by State or by the Processors market under the Exclusive Dealing Provision of Section 47 of Competition Law.

APPENDIX 7: List of Tables

Table 1: Main Dairy Products Prices in 2000 and 2020

Table 2: Snapshot of Global Prices of Milk and other Drinks

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Table 4: Current Dairy Item Prices

Table 5: Trend of Milk Production since De-regulation

Table 6: Drinking Milk Sales by Type

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Table 12: Average Victorian Farm – Income Statement

Table 13: Average Capital Structure of Farm in Victoria

Table 14: Return on Investment on Stock

Table 15: Price Increase Sensitivity Analysis

Table 16: Industry Profit Margins

Table 17: Size of foreign agricultural land interests by source country

Table 18: Foreign held water entitlement by country

Table 19: Effect of Price Floor

Table 20: World Main Milk Producers

Comment

John Dahlsen is a career Commercial Solicitor who holds an MBA from Melbourne Business School.

John has been a Director and / or Chairman of several major Australian companies including Woolworths Ltd and The Herald and Weekly Times Ltd. He co-founded Southern Cross Broadcasting (Aust.) Ltd. He is currently Chairman of JC Dahlsen Pty Ltd which he owns as well as being involved with several exciting start-ups.

Papers written

John has written a number of other papers, available on request:

Numerous papers on Banking, as below,

Murray Report: The Balance between Competition & Systemic Risk	Sept 2015
Parliamentary Joint Committee on Corporations and Financial Services:	
The platform of the submission to the inquiry: GSI should not have failed	Sept 2015
Supplementary Submission to the Parliamentary Joint Committee on	
Corporations and Financial Services	Sept 2015
Alternative Structure of the Australian Trading Banks	Aug 2016
Bankers Disease	Aug 2016
Banks: I See Things Differently	Aug 2016
Banks: Culture Reputation Values	Sept 2016
Bank Reform: Comment	Dec 2016
Banking Reform: Comment	Oct 2018
Banking Sector: Diversify or Refocus	March 2019
Banks: Conflicts, Tension, Frustrations	March 2019
Paradox	Feb 2019

APRA

APRA June 2018

APRA and Bank Structure March 2018

Senate Economics Legislative Committee: APRA Crisis Powers Dec 2017

THE HAYNE INQUIRY

What should happen Post Hayne RC July 2018

Structural Change and De-Mergers – Keys to Success July 2018

Prudential Inquiry into the Commonwealth Bank of Australia (CBA) Murray Inquiry, APRA, Hayne Commission: Regulators Running Riot June 2018

Why Section 46 of the Competition Act had to be reformed,

Local Government: Is it Broken?

Comment: East Gippsland Draft Annual Budget 2019/20

Why Melbourne Business School should remain independent,

Governance and strategy at The University of Melbourne,

Numerous other papers.

Escavox: A Start-up,

Bunnings and the ACCC,

Payroll Tax Reform,

Murdoch (draft / incomplete),

A summary of The Dahlsen Story (a family history) by Peter Synan,

East Gippsland Drought

How bad is it?

What should the community do?

Information on farm rates,

Farm economics.

Farmers Voice

Need for Farmers Voice,

Recommendations.

CV of John Christian Dahlsen

Company Director and Solicitor

Qualifications

Bachelor of Laws, University of Melbourne (1958)
Master of Business Administration, University of Melbourne (1969)
(John Clemenger Prize Winner as top student)

Career in Summary

Family Company	JC Dahlsen Pty Ltd Group (Chairman and Sole Owner)
Previous Charitable Activities	The Smith Family National Drugs Partnership Non Profit Australia Institute of Public Affairs Ltd (Councilor) Melbourne Business School Ltd (Chairman) Centre for Journalism University of Melbourne Little St Margarets Ltd (Chairman) (With others, acquired the school on its imminent closure)
Some Former Directorships	**Public Companies:** Woolworths Limited (Chairman) Melbourne Business School Limited (Chairman) Sothern Cross Broadcasting (Aust) Ltd (Chairman and Co.Founder) Herald and Weekly Times Limited (Chairman) and Director of Associated Companies: - Advertiser Newspaper Limited - Herald Sun TV Pty Limited - Television Broadcasters Pty Limited - Queensland Press Limited Myer Emporium Limited (Deputy Chairman) ANZ Banking Group Limited OVS Investment Corporation Limited Bell Group Ltd Bell Resources Ltd **Private Companies:** Myer Family Investment Companies WJM Pty Ltd Mining Project Investors Pty Ltd John Holland Group Pty Ltd Sandridge City Development Co Pty Ltd

Penrice Ltd
G S Private Equity Pty Ltd
Byvest Management Buyout Group
LEK (Member Advisory Group)

Banking Experience

Director of ANZ Banking Group for approximately 15 years
Many years as a member of the ANZ Credit Committee
Many years as the Chairman of the ANZ Audit Committee

Nature of Legal Practice

Partner: Corrs Chambers & Westgarth

Commercial Solicitor for over 50 years having practiced in all aspects of commercial law including takeovers, reconstructions, tax and trade practices and related issues.

Preparing extensive submissions to Tribunals.

For a number of years operated a large practice in Public Company Takeovers.

Advising Boards on strategic issues and as to the duties of directors and on relationships with shareholders and shareholder interest.
Advising in relation to directors duties generally.

Member of the three man Panel that reviewed The Audit Act 1994 in Victoria.

Completed a study for the Prime Minister's Community Business Partnership on the desirability or otherwise of establishing a Not-for-Profit Council of Australia.

On the Committee to interview Candidates for the I.A.C. (now Productivity Commission)

Family

Married to Gillian Hamilton York Syme on 21/09/1962
Children: Sarah, Geoffrey and Mary
Grandchildren: 9

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My colleague, Ramesh Bhalla, MBA, CA (ANZ), CPA, undertook extensive literature searches on the dairy industry, writing the material on India and assisted with editing and industry analysis. This has led to the sourcing of a number of graphs and tables evidencing most of the conclusions and opinions within.

Disclaimer

The writer is not a dairy farmer but has family members and close friends who are. In writing this paper they have been very helpful in providing a lot of practical data of what actually happens in the industry so my observations and opinions are better grounded. Nevertheless, the opinions and conclusions are still mine and I accept responsibility for them.

If you would like to discuss this paper, or acquire any of the other papers written by John Dahlsen, please email either:

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