

# **SUBMISSION BY FARMER POWER TO THE PRODUCTIVITY COMMISSION COMMENTS ON THE DRAFT REPORT INTO REGULATION OF AGRICULTURE**

## ***Overview***

Farmer Power is a voluntary association which represents the interests of dairy farmers across Australia. We are committed to addressing the current crisis facing dairy farmers which threatens the future of dairy farming as well as dairy manufacturing in Australia. Farmer Power is calling for regulatory reform based on good policy, including long term planning for halting the decline in milk supply (currently running at 10% annual decline), restoring Australia's export capacity (which has fallen from 80% to 20% of production) and safeguarding its food security.

The level of concern within the farming community is exemplified by the fact that recent public meetings across Australia were attended by around 1,000 dairy farmers (out of a total farming community of 6,000, many of whom are unable to leave their farms) and that rallies held in Melbourne, Brisbane and Adelaide attracted similar numbers. This level of participation appears to be many times greater than the membership numbers of the official dairy industry bodies that have been consulted by the Productivity Commission. We therefore claim legitimacy in representing the views of dairy farmers.

We do not wish to submit recommendations to the Commission on matters which affect only some dairy farmers, and have confined our comments to those matters which impact on most if not all dairy farmers across Australia. Our recommendations address the following issues.

1. Regulatory matters which have not been addressed by the Commission, despite being within the scope of the Terms of Reference for the report.
  - Compulsory Levies
  - Supply Chain Risk
  - Impact of Deregulation
  - Overseas Models for Checks and Balances
2. Competition Policy
  - Collective Bargaining
  - Effects Test
  - Mandatory Codes of Industry Conduct
3. Foreign Investment
4. Food Safety
5. Food Labelling.

## **1. Regulatory Matters that have been Overlooked**

### ***1.1 Compulsory Levies***

Following deregulation, dairy farmers were obliged by the Federal Government to contribute to the operational costs of the peak industry body Dairy Australia. These payments are deducted by the milk processors from the payments made to farmers for their milk. Farmer contributions to Dairy Australia amount to over \$30M per year, with the Australian Government making an annual contribution of around \$19M tied to research activities. Processors make no financial contribution to Dairy Australia's core funding, though they are heavily represented in its governance structure. The levy made by a typical farm is now around \$8,000 per annum, which may exceed the personal incomes of some struggling farmers. Effectively it has become a tax rather than a levy. It is used to fund a range of activities that benefit the industry as a whole, including dairy processors, and this puts an undue burden on farmers. It can be questioned whether the bulk of its activities are actually cost effective at all for farmers.

### ***1.2 Supply Chain Risk***

There are many examples of where farmers have had to absorb costs or risks for the industry as a whole as a result of inappropriate deregulation. For instance, farmers are now required to take out insurance against rejection of milk at the point of processing, despite the fact that contamination could occur in transport. Some farmers report receiving nil payments for batches of milk which are subsequently used in various dairy products. Another example is the installation of meters on milk tankers by the milk processors, with the cost of this being passed on to farmers. Farmers pay for transport of milk despite being paid for their product at the farm gate.

It is noted that deregulation was intended to provide certainty about price, and consistent prices across localities, but neither of these have eventuated. Some processors appear to be paying different prices to farmers based on the size of their farm or its location, with no clear rationale. The pricing formula used by milk processors does not provide a framework within which farmers are able to plan ahead to build their business, and invest in improved production systems. There is no certainty about the price they will receive until the end of each season, and when firm commitments to price are made by processors these are often dishonoured. Farmers have no come back in this situation. The pricing structure is also extremely complex, and open to interpretations that favour the processors. It is very difficult to ascertain what price farmers are actually receiving at any given time. What is clear is that any fluctuations in global price or downward pressures on domestic milk price are passed on to the farmer, while the processors maintain their profits and maximise the dividends they pay to their shareholders.

### ***1.3 Impact of Deregulation***

One unintended consequence of deregulation has been the introduction of restrictive practices by milk processors, to lock in their suppliers. Despite the lack of any contractual certainty about the prices they will receive for their milk, farmers are heavily penalised if they switch between processors. This is achieved by a system of "loyalty payments" which result in farmers sacrificing payments which would otherwise be made to them. The consequences for a farmer wanting to change supplier (eg because of poor payment practices) can be significant – anything between \$10,000 and \$100,000 as a lump sum depending on the size of farm. When farms are operating on extremely low margins, these penalties can prevent them from taking action which would otherwise appear to be in their best interests.

The system of loyalty payments is clearly anti-competitive, and appears to be feudal in the way that farmers are held captive to particular processors. Secrecy provisions are common, to prevent farmers from comparing prices between one another. There is no place for this in a market economy.

### **1.4 Overseas Models for Checks and Balances**

Australia's competitors have a range of mechanisms which provide checks and balances to prevent processors and supermarkets from exploiting dairy farmers. Currently the Federal Government has expressed interest in some of the US models which includes insurance against price fluctuation, and/or establishment of futures based price setting. Other mechanisms are being applied (and recently strengthened) in the UK and the EU). It is noted that the terms of reference for the current report include a requirement to *"examine whether regulatory approaches adopted in other countries may be relevant for Australia"*. We observe that the Commission has not met this requirement in relation to the dairy industry, and possibly with respect to other agricultural sectors.

## **2. Competition Policy**

### **2.1 Collective Bargaining**

We note and support the submission to the Commission made by Australian Dairy Farmers as follows.

*"(This) inequality of market and or bargaining power means that farmers are largely price-takers in the market and susceptible to at times questionable business practices. Farmers may be forced to accept standard form c contracts on a 'take it or leave it' basis or to operate under arrangements without the benefit of contractual security. As a consequence, collective bargaining is an important tool to help address these issues, and restore in some part a balance in the power of market participants."*

The Commission has recognised the previous support by the Federal Government for promoting collective bargaining amongst farmers, to counterbalance the power of retailers and processors and achieve fairer pricing of farm produce. The Commission now appears not to support this on the basis that *"there appears to be a cultural aversion in Australia to participating in cooperatives"*. We would urge that this view should be reconsidered. Cooperatives have played a vital part in development of Australia's dairy industry, and there are several cooperatives still functioning as processors and milk pooling agencies. Moreover the current crisis is reinvigorating interest amongst dairy farmers in reforming cooperatives to increase their collective bargaining capacity. This has anticipated the foreshadowed changes to competition law (now apparently opposed by the Commission) which would remove barriers to collective bargaining.

### **2.2 Effects Test**

The Commission has claimed that *"The existing competition regulation and oversight is adequate for managing concerns about abuse of market power by supermarkets and traders engaging with farm businesses."* It clearly is inadequate for the many dairy farmers left in financial ruin as farmgate milk prices are opportunistically cut by exporting processors. It is clearly inadequate for the farmers whose returns from fresh milk are cut below the cost of production as a result of long term milk supply contracts negotiated by the major supermarkets for their homebrand milk, apparently using shelf space for name brand dairy products as a bargaining point. It is not adequate for providing food security to Australian consumers as declining milk production means that Australia

will soon be a net importer of dairy produce. It is not adequate for safeguarding Australia's economy as a whole.

We draw the Commission's attention to the current situation faced by suppliers of Murray Goulburn Cooperative who have experienced a retrospective clawback of money they have already been paid for their milk. The imposition of the clawback is possibly illegal under current law but it will take around 18 months to mount a class action to determine this, and many farmers will have been forced out of the business in the interim. Introduction of the effects test would discourage processors and supermarkets from pursuing such unconscionable conduct in future by increasing the certainty that class actions such as this would be successful. We had hoped that the introduction of the effects test as proposed by the Federal Government would prevent such disastrous events for recurring in future. News that the Commission is discouraging the Government from this course of action is very disappointing.

### ***2.3 Mandatory Codes of Industry Conduct***

We are interested in the Commission's observations about mandatory codes. A mandatory Code of Conduct for the dairy industry might provide a useful pathway to a better future for dairy farmers. However it would need to draw on lessons learnt from implementation of the Horticulture Code of Practice, particularly in addressing the way that producers are discouraged from making complaints by fear of retribution from processors and sellers. Such intimidation is clearly evident in the dairy industry.

Core components of such a Code would be as follows.

- ***Benchmarks for price setting***  
An effective and fair price formula for setting a minimum farmgate price needs to reflect the fact that milk supply is legally defined as an essential service, that there are global price fluctuations and currency exchange fluctuations beyond the producers' control, but also that most milk is destined for the domestic market where consumers clearly demand a high quality domestic product. Given past experience, a benchmark minimum price may need to be established by an independent government appointed tribunal. The benchmark should reflect market conditions (supply and demand globally and domestically) but also ensure that there are safeguards against farmgate milk price falling below the cost of production (insurance, price averaging, price futures etc).
- ***Ethical milk supply contracts***  
Contracts need to be clearly written, and to give certainty about price for the duration of the contract period (no more clawback). Penalising farmers for switching processors if the price changes should be banned. Current secrecy requirements about milk supply provisions should be abandoned so that processors compete fairly in the market.
- ***Farmer levies***  
At the moment farmers bear the cost of running Dairy Australia (despite the fact that processors have greater influence over the running of the organisation), as well as the Dairy Food Safety Victoria. These costs are deducted from the price they are paid for their milk by the processors. Fees for belonging to dairy industry bodies are also

deducted from milk payments unless farmers realise what is happening and opt out. Farmers also pay for transporting their milk to the processor, and testing milk quality at the factory, despite the fact that milk is purchased at the farmgate. Penalty provisions mean that farmers don't get paid for milk that falls below required standards, even though the processors use this milk and gain economic benefit from it. Given that they are not in control of the testing process, there is scope for processors to manipulate results in their favour. This system is unfair. These costs (where justified) need to be distributed along the supply chain, and any payments by farmers should be made directly and accounted for in writing, not deducted from the price they get for their milk.

- **Governance**

The governance of Dairy Australia and the various industry bodies established to protect farmers' rights needs to be reformed so that dairy farmers control these organisations. This requires a thorough overhaul of the constitution of Dairy Australia (which has been likened to the government structure of North Korea), democratisation of electoral processes for all these bodies, and removal of conflicts of interest exerted through sponsorship or other deals.

The powers to enforce the Code would need to be appropriate and effective. The maximum level of fines that can be imposed by the ACCC should be increased, and there would need to be resources to respond quickly to reports of infringement. This would involve establishment of a fair and equitable dispute resolution process as well as punitive response. The cost of this would ideally be met by the industry as a whole, but if no other appropriate mechanism can be found it may be acceptable to farmers for the cost of enforcement to be met from the existing Dairy Australia budget (as a replacement for other less relevant expenditure).

### **3. Foreign Investment**

The Commission's draft report makes the sweeping statement that "*Foreign investment has been, and will continue to be, important for improving the competitiveness and productivity of the Australian agricultural sector.*" While this may be true in general, it does not mean that all foreign investment should be promoted without question, and in particular that foreign purchase of agricultural land is in Australia's best interests. Even in the short term there could be adverse consequences. This is particularly exemplified in the dairy industry, where dairy manufacturing requires a critical mass of feedstock, and investments in plant and equipment have been made on the basis of continued supplies. While reduction in supply can take place quickly (as with current increased rates of herd slaughter) achieving an increase takes many years of lead time. Recently there has been the prospect of overseas buyers taking ownership of a large number of farms in Victoria and Tasmania (which could be bought cheaply in the current dairy crisis) and removing milk supply from current processors. This could lead to collapse of a \$14B per annum industry and the associated 43,000 direct jobs (plus an estimated 100,000 indirect jobs, largely impacting on regional towns).

### **4. Food Safety**

Dairy farmers fully appreciate the need for stringent food safety standards, and have demonstrated excellent performance in this regard. In this regard there is concern over industry chatter about

larger/corporate farms being exempted from milk testing by processors, placing the overall quality and safety of Australia's dairy produce at risk. Smaller family farms are rigorously tested.

One of the factors that contributes to the disempowerment of farmers in negotiating a fair price is regulation that effectively prevents dairy farmers from selling their milk directly to consumers. It is noted that in the EU, New Zealand and increasingly parts of the USA, raw milk sales by farmers are permitted subject to a farm food safety plan or its equivalent, using approved storage and dispensing equipment. It is ironical that regulations preventing raw milk sales in Australia do not apply to New Zealand, despite the existence of a common standard. We would advocate the outcome based requirement of FSANZ that *"A food will be considered to be safe, in relation to the matter dealt with by a standard, if it complies with that standard."*

There would be other ways for farmers to be empowered to sell directly to the public, to establish a competitive basis for farmgate pricing. While the currently approved processes for pasteurisation are not within the reach of most dairy farmers, there are alternative methods of sterilizing milk which could be developed and approved if there was a will in the industry to do so. Some of these would offer health advantages, as factory pasteurisation is often carried out for long haul, ie applying sterilization practices that are unnecessary for localised supply chains. Alternative technologies include high pressure treatment, pulsed electric field pasteurisation and ultraviolet pasteurisation as examples.

A move to outcome based regulation of raw milk sales and/or required sterilisation technologies would be of considerable benefit to farmers.

## **5. Food Labelling**

We draw the Commission's attention to the fact that the Australian and New Zealand dairy industries are distinctive globally because they are still predominantly based on pasture fed herds. Milk from pasture fed cows demands a premium overseas, and it is likely that in future Australian consumers will become more discerning on this issue. This milk is superior in quality (eg protein content, absence of chemicals used to control health in intensive dairies). If Australian dairy farmers are to be rewarded for their superior product there should be scope of labelling to promote this.