Agricultural Competitiveness White Paper Submission - IP189
Farmer Power
Submitted 6 March 2014

SUBMISSION BY FARMER POWER TO THE WHITE PAPER ON AGRICULTURAL COMPETITIVENESS IN AUSTRALIA

Summary

Farmer Power is a non-statutory representative body which advocates for the rights and interests of all farmers in Australia. This organisation has come into being because of the failure of the statutory industry bodies to work effectively to advance farmers' interests. Membership is particularly strong amongst dairy farmers, prompted by the serious concerns they have about the structure of their industry, and the consequences for the viability of dairy farming in Australia.

The focus of this submission is Australia's dairy industry, as this provides an excellent illustration of how Australia's potential food industries are threatened by inappropriate industry structures which remove incentives for primary production. Unless this critical issue is addressed as a matter of urgency, Australia will be unable to take advantage of the significant opportunities it has to become "the delicatessen of Asia" (National Food Plan 2013), producing high quality foodstuffs for an expanding and increasingly lucrative global market. In fact the reverse is happening, with domestic production collapsing and Australian consumers becoming increasingly reliant in imported foodstuffs.

The recommendations made in this submission are summarised as follows. Farmer Power calls on the Australian Government to implement these measures as a matter of urgency, in order to prevent the collapse of this industry and consequent loss of over 100,000 jobs.

Requested Action	***Submission reference***	***Target timeline***
Prepare a strategic analysis and a national action plan for the dairy industry	Recommendation 12	by end 2014
Overhaul the regulatory regime to remove unnecessary and restrictive practices	Recommendation 10	by mid 2014
Establish a moratorium on farm foreclosures and bankruptcies until Recommendations 10 and 12 are implemented	Recommendation 6	until mid 2015
Reform current industry restrictive practices in establishing the farmgate milk price, making "loyalty payments" and granting export licences	Recommendations 2, 3 and 7	by end 2014
Establish mechanisms that enable farmers to sell milk directly to the general public	Recommendation 1	by mid 2014
Completely overhaul the structure and funding of statutory industry bodies	Recommendation 4	by end 2014
Review the unintended consequences of farm amalgamations and corporatisation for sustainable milk production performance	Recommendation 5	by mid 2014
Review Council rating imposts on dairy farmers, to fill budget black holes	Recommendation 8	by mid 2014
Work with the banking sector to introduce new tenure models for prospective new dairy farmers	Recommendation 9	by mid 2015
Provide strategic direction in targeting and facilitating new export markets for dairy produce	Recommendation 11	by mid 2014

Farmer Power would be pleased to assist the Government further in the preparation of the White Paper or the implementing of the above recommendations, as appropriate.

TOR1 Food Security in Australia and the world through the creation of a stronger and more competitive agricultural sector

Food security in Australia is threatened by the current trend for decreasing domestic milk production and increasing reliance on imports. Since deregulation of Australia's dairy industry in 2000, milk production has declined from 11.2B litres per annum to around 9B litres per annum. The rate of decline appears to be accelerating, with reductions of around 9% pa reported for the last few years in key production areas, and an overall decline of 3.5% reported nationally last year. While year to year variations can be attributed to extreme events (eg fire and flood) or climatic variations (eg drought) the long term trend appears to be independent of these factors.

While Australia has historically been a significant exporter of dairy products, the surplus available for export has declined considerably, falling from 60% of total production to around 40% over a ten year period. At the same time, the volume of imported products has dramatically increased, as illustrated by cheese imports which are now 70% higher by volume than they were ten years ago. This is despite fairly static levels of per capital consumption.

On current trends, it is likely that Australia's dairy industry will shrink to around 5B litres pa of milk production within the next ten years (and possibly sooner), at which point we would become a net importer of dairy products. Given soaring global demand for dairy products, and consequent pressure on prices, this is a significant threat to Australia's food security.

At the global level, increased demand is outpacing supply, with growth in Chinese consumption particularly significant. China absorbs around 35% of internationally traded dairy products, and its consumption is growing at an estimated 5% per annum. Australia's contribution to global trade in dairy products has shrunk from 15% to 7% since deregulation, at a time when New Zealand has doubled its production and now captures 35% of the world market.

On current trends, Australia will be unable to contribute to global food security in dairy products within ten years or sooner.

Farmer Power believes that Australia's decline as a dairy producer is largely the result of restrictive industry practices which adversely impact on farmers' ability to produce milk cost effectively. While industry deregulation could and should have resulted in a more competitive and efficient dairy sector, there has been a massive failure to deliver the predicted benefits. Farmers are calling for an overhaul of the industry to rectify its current distortions, and if this restructuring does not take place very soon it is likely that the whole sector will pass the point of possible recovery.

TOR2 Means of improving market returns at the farm gate, including better drought management

Better drought management is a concern for farmers, but this is an issue that they are already addressing through pasture management, water management and stock control. Improved farming practices will not deliver increased farmgate returns unless complemented by other measures. In fact, the significant investments made by dairy farmers in drought protection in the early 200s are now adversely impacting on their financial sustainability, because of anti-competitive milk pricing practices within the industry.

Far more significant for farmgate returns is the way the industry is structured. Farmer Power believes that removal of restrictive practices within the dairy sector is essential if farmgate prices are to deliver a sustainable return to farmers, sufficient to keep them in business. Examples of restrictive practices are provided as follows.

- ***Sale of milk by farmers***

The requirement that milk is pasteurised (or sterilised by other means) before sale to consumers was introduced in the 1960s, with restrictive regulations dating from the 1980s. Since then farmers have increasingly lost the capacity to negotiate a price for their product that reflects consumer demand. This is a clear distortion of what was intended by deregulation. Pasteurisation is now only permitted by dairy manufacturers who are licensed by the relevant State statutory food safety bodies. There are limited options for farmers as to where they sell their milk, and many of the milk processors have interwoven interests (eg owning shares in one another's companies, or contracting out processing between one another). Concentration of processing in the hands of a few companies means that milk is increasingly being processed for "long haul", ie with more extensive treatment than would be required for small catchments and local retailing.

There is an irony in the fact that children were actually provided with raw milk to drink each day at school on health grounds from the 1940s on, unrefrigerated even on hot days, well before the introduction of pasteurisation as standard practice in the 1960s. This contrasts with the present day where children and adults are prohibited from drinking raw milk on health grounds. This does not appear to be justified by any failures in milk quality or dairy hygiene on the part of farmers, many of whom were themselves raised on raw milk.

There is increasing consumer reaction against the clear distinction between "real milk" and the white liquid that is supplied in shops. This has spawned a black market in "pet milk" and "bath milk" which now accounts for around 1% of milk sales (despite limited opportunities for buying it). As consumers flock to natural unprocessed products this demand is likely to soar. Suppliers have been threatened with hefty fines of more than $40,000. Farmers who have sold shares in cows and then supplied shareholders with milk have been taken to court. Some farmers claim that contamination of milk supplies was a very rare occurrence prior to the requirement for off-farm pasteurisation, and cannot understand why they have lost control of their product. This is in the face of more substantial risks of field contamination in other fresh food supplies which has not led to regulation requiring (for example) hydroponic cultivation, significant occurrence of food contamination amongst fast food outlets which have not led to banning (for example) cooked chicken sales, and food poisoning outbreaks arising from poorly reheated foods in the home which has not led to a ban on sales of frozen dinners. Instead, research has been carried out to support development of allowable practices of sale of raw meats including chicken, fish and raw eggs to minimise risks of food contamination.

In the EU and in New Zealand consumer demand for raw milk has been met by licensing farms to sell their milk based on farm based food safety plans. This recognises that controlling quality along the value chain from farmer to consumer can actually reduce contamination risks. Food Standards Australia New Zealand is currently calling for submissions about sale of raw milk products in Australia, but it is apparent that industry bodies are opposing any relaxation of the current regulatory regime (and even misinforming the public about the current review). This could be because of the influence of dairy processors, who are well represented on these bodies.

An alternative to allowing sale of raw milk would be permitting farmers to practice minimal milk sterilisation procedures for retail sales, providing an alternative to the heavily processed retail product that is currently available. While it is acknowledged that a few farmers have invested heavily in establishing pasteurisation plants that meet current licensing requirements, this is prohibitively expensive for most dairy farmers, especially in the current fiscal environment.

Recommendation 1: Farmer Power recommends that the FSANZ review of raw milk sales in Australia be revisited with a view to responding constructively to consumer demand for less processed milk, as well as the need for farmers to be able to sell directly to the public.

- ***Pricing of milk by processors***

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.

The pricing system is such that it is very difficult to ascertain what price farmers are actually receiving at any given time. It is noted that deregulation was intended to provide certainty about price, and consistent prices across localities, but neither of these have eventuated. Some suppliers are paying different prices to farmers based on the size of their farm or its location, with no clear rationale.

There has been a long term trend for prices to decline. There has been no real increase in farmgate prices since the 1960s, adjusted for inflation, despite significantly increased input costs (eg water, fuel/power, grain). The Global Financial Crisis and concurrent appreciation of the Australian dollar led to processors suddenly and significantly dropping the milk price paid to farmers, from around 55 cents per litre to around 32 centre per litre. Any increases since that time have been followed by further price reductions, often significant and imposed without notice. It is apparent that processors have passed on to farmers all the costs associated with the currency fluctuations, apparently maintaining their own profitability and even increasing it. There are current claims by some processors that farmgate prices will be higher in 2014 (by as much as 20%, reflecting the trend in global milk prices) but past experience has led most farmers to doubt these predictions. Dairy processors have so far maintained their profits even with declining milk production, by putting even more downward pressure on the milk price, and there are no clear incentives for this to change. This is symptomatic of a very irrational market, arising from a dysfunctional industry structure.

While prices are linked to butterfat content, it would appear that the usual prices being paid to farmers in Victoria (which accounts for around 60% of Australia's milk production) are currently around 35-42 cents per litres. In New South Wales and Queensland, prices of 45-55 cents per litre are more common. Last year alone, the price paid for milk in Victoria went down by 6 cents per litre while costs of production increased by an estimated 6 cents per litre – effectively cutting earnings by 30%. At these rates, farmers' return on equity is around 1.3% on average, with over 20% having <u>negative</u> cash flow. Confidence is now so low that in some parts of Australia as many as one third of farmers do not expect to be in business in five years' time, and they could well be right (Dairy Australia 2013 farmer survey). One piece of independent research concluded that on present trends the average net farm income would be zero by 2017. Farmer Power estimates that a price of 55-60 cents per litre would be the minimum required for dairy farmers to establish a sustainable business footing, and this should be readily achievable in the context of overall dairy performance and earnings in Australia.

The downward pressure on milk prices in Australia has been exacerbated by supermarket discounting of retail milk prices. It was initially expected that lower prices would drive an increase in demand for milk. There has in fact been only a small increase in demand, and this may have worsened the shortage of milk supplies available to milk processors for manufacture of value added products. Long term contracts for supply of cheap milk to the major supermarkets are likely to discourage milk processors from raising the prices paid to farmers. However Farmer Power does not believe that the problems of farmgate price are a direct consequence of low retail pricing, but rather that the core problem is an imbalance of pricing power between farmers and processors.

The situation in Australia can be contrasted with that of New Zealand. In 2000 Australia and New Zealand produced similar quantities of milk. While Australia's milk production has fallen over the past thirteen years, New Zealand's production has doubled, and is now more than twice that of Australia. Last year while Australia's production declined by an estimated 3.85%, New Zealand's production reportedly increased by 6.25%. A major factor in this success story is that farmers in New Zealand receive a farmgate price of around 55cents per litre (AUD) and have lower input costs because of the local climate.

Recommendation 2: The Australian Government should immediately hold an inquiry into the way that farmgate milk prices are set, with an opportunity for farmers to make constructive suggestions on how the current system can be reformed to better protect their interests, and with a view to introducing a revised system in 2015. Note that the current industry bodies should be distanced from this process.

- ***Cost penalties imposed on farmers***

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. There is no place for this system in a market economy.

Recommendation 3: The practice of "loyalty payments" which lock farmers into supplying particular processors should immediately be banned. Farmers who are subject to restrictive practices of this kind should have an avenue for reporting breaches to the ACCC.

- ***Levies imposed on farmers***

Following deregulation, dairy farmers were obliged 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. The levy made by a typical farm is around $5-7,000 per annum, which may exceed the personal incomes of some struggling farmers. Effectively it has become a tax rather than a levy.

Farmer Power believes, based on the views of its members, that Dairy Australia is not effective as an industry body in representing the interests of dairy farmers. It is noted that:

- dairy processors do not contribute to the operational costs of Dairy Australia but they are over-represented on the board, and apparently see benefit from the operations of Dairy Australia

- Dairy Australia's constitution is such that the dairy processors (Australian and international) and major industry bodies control the selection of all board members, and it appears that many of the few farmer representatives are actually individuals with ties to the processors

- Dairy Australia activities do not serve the interests of farmers (eg none of its research activities have addressed the key concerns of farmers about farmgate price, direct sale to consumers or elimination of restrictive industry practices)

- Dairy Australia does not accurately describe the state of the Australian dairy industry in its reports to Government, so that the Australian Government receives poor returns for its significant investment (presumably over $150M since deregulation)

- Dairy Australia personnel have significant conflicts of interest in their ties to dairy processors, acting as a "closed shop" in relation to other interests (as just one example, the incoming Chairman of Dairy Australia is married to a board member of a dairy processing company)

- there appear to be entrenched personal links between key personnel in Dairy Australia and those of other industry bodies such as the United Dairy Farmers of Victoria (which was formed to represent the interests of a majority of dairy farmers) so that they seem to operate as an "old boys network" opposing participation by new blood, refusing to disclose meeting agendas to members, etc

- farmers have the right to disapprove proposed increases in the levy to Dairy Australia (by way of its constitution), and did so in 2012, but this has been met by a proposed change to the levy setting mechanism by Dairy Australia with a view to securing the planned increase in its funding

- an additional annual levy of $1.2M was introduced by agreement between dairy processors and the industry bodies, to help with the running costs of Australian Dairy Farmers, and the costs are being recovered from farmers without their agreement

- a review of Dairy Australia conducted in 2012 was claimed to be "independent" but was internally commissioned and controlled, and conducted by personnel who have close ties with Dairy Australia. Farmers had very limited input to this review.

Further levies are collected from farmers through the State based farmer organisations. Farmer Power members acknowledge the good work done by the South Australian Dairy Farmers' Association in establishing a new direct retail outlet for farmers. However Farmer Power members are particularly critical of the United Dairy Farmers of Victoria which appears to operate in secrecy and resists any change in its leadership. UDFV is the dominant voice within the national Australian Dairy Farmers. Levies for membership of the State bodies could cost a typical farmer around $2,000 pa. Unlike the Dairy Australia levy, the State based levy is not compulsory, though farmers have often been warned that if they do not join up their interests may not be accurately represented. Nevertheless the fact that farmers feel that their membership is not producing any value has resulted in a situation where some farmers have now left the organisation, and others are likely to follow.

An example of industry bodies acting outside farmers' interests is illustrated by the recent lobbying by both Dairy Australia and the United Dairy Farmers of Victoria in relation to the potential takeover of Warrnambool Cheese and Butter. Support was given to the Murray Goulburn Co-operative, despite the very evident feeling of many dairy farmers that this would not be in their best interests. The conflicts of interest within the industry bodies, with board members and relatives who are actively involved in Murray Goulburn, should have precluded such lobbying. Many of Farmer Power's members are concerned that an expanded Murray Goulburn would have been able to put further downward pressure on milk prices, and point to the Co-op's past record in that regard. There were also concerns about Murray Goulburn's debt levels (now and following any takeover) and how this would impact on the Co-op's ability to pay farmers a fair price. This could have led to a complete collapse of the company, following the path previously taken by Bonlac in over-reaching in its revenue raising. Farmer Power has previously issued a press release urging the industry bodies to keep out of the takeover debate.

Recommendation 4: The Australian Government should institute a truly independent review of how Dairy Australia, Australian Dairy Farmers and the State Dairy Farmer organisations are governed, the priorities for their activities, the level of funding they require to undertake these activities, the level of fees that should be paid by dairy farmers, dairy farmer representation, and their accountability to dairy farmers as well as other stakeholders. The present structure should be completely overhauled (preferably replaced) by the end of 2014.

- ***Absorption of increased production costs and risks by farmers***

The way in which industry costs and risks have been absorbed by farmers rather than processors is well illustrated by reported industry earnings and profits. Almost without exception, the major processors are reporting increased profits in 2012-2013, even where their production levels have been reduced by the emerging constraints on milk supply. For example, cheese production fell by 17% last year alone, due to shrinking milk supplies, yet most of the major cheese producers recorded record profits.

It is noted that farmgate prices are seen as the key issue affecting farm viability by farmers, but this hardly rates a mention in the various industry bodies' reports to government. As examples, Dairy Australia's "*Dairy Industry Sustainability Framework*' (December 2012) and WestVic Dairy "*Filling the Glass*" strategic directions document (August 2012) predict increasing efficiencies gained by farm amalgamations and corporatisation of farming as current dairy farmers quit the industry, and set ambitious targets for increased milk production based on these assumptions. In fact, the unsustainable level of current farmgate prices, and the lack of control farmers have over the pricing of their product, provides an environment where large farms and corporate farms will find it even more difficult to thrive than smaller family farms. In a situation where farmgate prices fail to cover operating costs, family farmers are often prepared to work long hours for little or no return (at least for a while) but larger commercial operations cannot rely on unpaid labour. This is already evidenced by corporate farms being abandoned in some production areas, exacerbating the loss of production.

There are other examples of where farmers have had to absorb costs or risks for the industry as a whole. 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.

On top of absorbing costs from dairy processors, dairy farmers have been faced with sharp price rises of their own. Following deregulation they were encouraged by governments and processors to invest in increasing their efficiency, including drought proofing. There was ready access to relatively cheap loans in the early 2000s, and farmers were assured that there would be good returns from these investments. Repayment of these debts is now a considerable impost on farm operations, given the fall in earnings. Significant cost increases have been incurred for grain, with prices doubling in relative terms since deregulation – grain purchases can account for around 30% of milk production costs. The price of water has increased dramatically, and some farmers near to urban centres have found themselves paying domestic water prices. Power bills have risen relative to other costs. It would not be unusual for a dairy farmer to be paying around $35,000 per year for purchasing water, and $15,000 per year for pumping water, and some farmers in the important Northern Victoria production area have found it impossible to purchase the water they were previously promised. Fuel prices have increased dramatically, with a marked differential in terms of urban and rural prices, and an even more damaging cost differential between petrol and diesel.

In the face of poor farmgate prices, milk production is steadily declining. Farmers are quitting the industry by choice or because of unmanageable debt, and some are reducing their herd size to reduce input costs. However the advice being provided to government by the industry bodies surprisingly paints a bright future, and fails to highlight the dangers of the present situation.

In a market economy, it can be expected that in time reduced milk supply will put pressure on milk prices, so that processors will pay more to ensure supplies. It is surprising that this has not already occurred, given that most processors are already experiencing increasing difficulties in securing the milk supplies they need, and factories are running below capacity as a result. The continued downward pressure on milk prices may be explained by seeming collusion between a limited number of processors, with vested interests in keeping farmgate prices as low as possible. Such behaviour would undoubtedly be short sighted and self defeating, but short term profits create a powerful incentive.

In practice even a substantial price rise may not lead to correction within this particular industry sector, once production levels are falling sharply. The lead time for any increase in herd size is 2-3 years, and this can only be achieved by small increments, by which time processors may be forced to reduce their own production capacity. It should be noted that larger corporate farms may have greater difficulty in increasing herd size than smaller family farms, because their cows may have a more limited productive life and need more regular replacement. The added stress of walking long distances to be milked on large farms can result in a productive life of around four years (and lower yields), compared with double this productive life on a smaller farm. Also farm amalgamations have sometimes attracted foreign investment, but lack of familiarity with local farming practices has led to subsequent farm abandonment. This reflects the fallacies about economies of scale within the dairy industry.

The ability of dairy production to recover, even with increasing farmgate prices, is also hampered by the ongoing loss of skills from the dairy sector (see TOR6). Poor farmgate prices has led to a situation where working for a dairy is a most unattractive proposition, with poor pay and conditions. Many farmers are cutting back their employment and relying on their own family members to work long hours unpaid. As existing farmers quit, even these skills will be lost to the industry. This is what makes the current situation particularly critical, with urgent action required to halt the current decline.

Recommendation 5: The Government should commission an independent report on the actual impact of farm amalgamation and corporatisation on dairy productivity and herd performance that is evidenced on the ground, and from this develop realistic strategies for retaining industry capacity and improving dairy production volumes. This report should have guidance from a steering committee on which farmers are well represented, and include a call for public submissions. The timeline for presentation of recommendations should be no later than October 2014.

TOR3 Access to investment finance, farm debt levels and debt sustainability

Farmers have historically relied on the real estate value of their farms as security for borrowing for capital investment. More recently those with negative cash flow have had to borrow in order to feed their families. The tightening financial markets since the GFC have led to demands for borrowings to be secured not only against property, but also against evidence of a capacity to make repayments. Declining farm incomes has created significant obstacles to obtaining finance, and the consequent decline in farm resale values has exacerbated this problem. Many farmers are now unable to sell their farms, because dairy farms are no longer an attractive investment, so there is no way out of unmanageable debt.

The previous Government's proposals establishing a National Rural Reconstruction Bank to buy back bad farm debts has been welcomed, but this $420M package can only partially address farm debts which have been growing at 10% per year and are now estimated to be worth around $5B. The Australian Bureau of Agricultural Research Economic and Science estimates average dairy farm debt as $701,500 (ABARE 2013). In the past year a majority of dairy farmers have increased their debt levels simply to maintain liquidity rather than to invest in farm improvements.

Some dairy processors have offered loans to farmers as a bail out measure. However there are strings attached to these loans which tie suppliers even more strongly to particular suppliers (eg using farmer-owned shares as security). Some of these loans involve interest rates which appear to be well above commercial bank rates (for example, quoted as 11% pa).

The critical state of the farmers within the dairy industry as well as other industries demands action to alleviate debt and restore confidence in the future. However this will only be a short term measure, and more systemic reform is required to establish farm sustainability into the future. Within the dairy industry particularly, there are excellent prospects for achieving farm profitability if the earnings from the industry are fairly apportioned between farmers and processors. At present farmers appear to be wearing most of the costs and the risks for the industry as a whole, while the processors are making record profits. As farmers quit or go into receivership, supplies of milk are dwindling, but the market is failing to correct itself by raising milk prices, even in the face of increasing global prices and a depreciating dollar.

It is noted that milk processors tend to regard a profit margin (after all costs, depreciation and tax) of 5% of sales as a minimum threshold for industry sustainability. If farmers were able to structure their businesses on a similar basis, and fully price their own labour as part of farm production costs, there would be no debt crisis. The global prices and demand trends for dairy products suggest that a rationally structured industry should deliver such returns to farmers, and this would enable Australian farmers to expand production in line with increased international demand. This could involve abandoning the current industry structure and rebuilding farmer controlled co-operatives (of which there are virtually none left) as the fresh milk processors which provide pasteurised milk for further processing by other industry players.

Recommendation 6: Farmer Power fully supports proposals for buy back of farm debt as a short term measure, but urges the Australian Government to look for more systemic long term reforms including support for industry restructuring. In the meantime Farmer Power calls for the Government and the banking sector to *impose a moratorium on foreclosure of dairy farms and farmer bankruptcies until a new strategy for the dairy industry has been established, providing farmers and lenders with better prospects for the future.*

TOR4 The competitiveness of the Australian agricultural sector and its relationship to food and fibre processing and related value chains, including achieving fair returns

The dairy industry has the potential to demonstrate that Australian agriculture can be highly competitive, generating sufficient returns to put farming on a sustainable business footing. The extent of current overseas interest in making investments in Australian dairying infrastructure is demonstration of its relatively low costs. Rising world prices and the premium placed on Australian product clearly demonstrates a sustainable business framework for the industry. The problem is that the economic returns from the industry are not being passed on to farmers, and this threatens the whole industry with collapse.

Opening up new opportunities for farmers to become more active participants in the value chain, rather than bearing the majority of costs and risks for all other participants, is highly desirable. The Australian Government can play its part by ensuring that restrictions on economic activity are removed, so that particular companies and sectoral interests are not favoured over others.

An example of a restrictive practice affecting both dairy farming and livestock rearing is the limitation placed on export of offal from abattoirs. There is a very large unmet demand for offal from the Chinese market and other Asian markets. Much of the offal produced by abattoirs is wasted, with little being processed for human consumption and some being processed as pet food. However accessing the lucrative export market has apparently been restricted to only two abattoirs in Australia which are licensed to export offal. Other abattoirs are permitted to process offal for the domestic market (where there is little demand) but not to export it (where there is high demand and good potential earnings).

Recommendation 7: Restrictions on export participation should be lifted, to broaden opportunities for product development and participation in overseas trade.

TOR5 The contribution of agriculture to regional centres and communities, including ways to boost investment and jobs growth in the sector and associated regional areas

Most regional centres have been built on the farming economy. While larger centres have since created self-generating urban economies, servicing agricultural catchments remains an important function. Smaller centres continue to rely on the agricultural sector as an economic driver. Agriculture sustains businesses involved in transport, plant and machinery sales, animal health and nutrition, seed and fertilisers, small engineering, trades, value adding and packaging of farm produce. In turn, the employees of these industries create a demand for other services including housing, retailing, recreation, health and education.

The multiplier effect of dairy farming on regional economies has been estimated as 7 off-farm jobs for every on-farm job, and around 5 on-farm jobs for every farm. In the current situation on-farm employment has probably been halved to save on costs, with farmers replacing employed workers by the unpaid work of family members over long hours (16 hour working days for husband and wife teams are not unusual). This could mean that the current crisis in dairying is placing 100,000 jobs at risk, probably with at least 20,000 jobs already lost.

The loss to smaller regional centres is not just about money and jobs. Many have been supported by the voluntary efforts of farmers in emergency services, charitable services, recreational clubs and the like. Farm amalgamations and corporatisation of farms reduces the capacity of these social institutions.

Local governments in rural and regional communities are often heavily dependent on the property rates paid by farmers. When farmers are in financial stress, payment of rates is a significant cost burden, sometimes enough to bring about a financial tipping point. A rates bill of around $10,000 p.a. would be typical for dairy farmers in Victoria. It is noted that despite a marked devaluation of dairy farming properties, there has been no consequent reduction in rates, rather the reverse. There is a possibility that cash strapped local councils will seek to draw even more of their resources from farmers. For example, in Victoria the poor performance of the Vision Super local government superannuation fund has led to periodic adjustments through huge periodic levies (several millions of dollars in 2012 even for the smallest councils, enough to wipe out their entire capital works programs) being made without notice on local councils. These black holes have to be filled through rate rises, and farmers are an easier target than the more numerous urban ratepayers.

Recommendation 8: An assessment should be made of local government rating systems as they impact on farmers, with a view to ensuring that reduced farm values are reflected in rate reductions, and that councils do not unduly rely on farm rates to compensate for revenue shortfalls.

TOR6 The efficiency and competitiveness of inputs to the agriculture value chain – such as skills, training, education and human capital; research and development; and critical infrastructure

At present there is simply no point in encouraging job pathways into dairying unless there is a concurrent pathway for farms to achieve business viability. However if such a framework can be established quickly there is no doubt that dairy farmers would rehire farm workers to provide relief for themselves and their families. There is likely to be a potential for creation or replacement of around 15,000 on-farm jobs in the short term, with associated job creation in service industries and dairy processing. This will also ensure viability of the current expansion plans of dairy processors, which have the potential to create many more jobs if factories run at capacity. The multiplier effect of this job creation could amount to more than 50,000 new jobs created.

Australian dairy farmers have made remarkable increases in production efficiency over the past ten years, demonstrating a capacity for excellent business performance. Unfortunately the economic gains evidenced by dairy processors' profits have not been passed on to farmers, while everyone else in the value chain appears to have benefited. Many years ago it was a credo in the dairy industry that every trailer driver (collecting the milk from farms) wanted to be a dairy farmer, but now the reverse has happened and virtually every dairy farmer would happily swap places with a trailer driver. The drivers' wages would have doubled in relative terms while many farmers' wages have shrunk to the minimum wage or less.

Some of the production efficiency measures being promoted by Dairy Australia and others are self-defeating in terms of production costs. For example, farmers have been encouraged to introduce pregnancy testing of cows as a standard procedure to ensure appropriate nutrition, drying off and healthcare. This can save wastage of potential milk yields and other resources. However the cost of pregnancy testing has risen to the point where it is now prohibitive for many farmers, with veterinary practices charging more than $3,000 for recent testing on a typical dairy farm (2 vets working for 2 hours). Other service industries have also raised their charge out rates, with out of hours mechanics recently charging (for example) $500 for a weekend farm visit to change a tractor tyre (on top of $2,000 to replace the tyre).

Some of the escalating charges made by service industries are due to out of hour penalty rates paid to employees, which adversely impact on a 24/7 dairy farming business operation. Liberalisation of labour laws would undoubtedly assist the farming sector and its associated service industries. For on-farm work, liberalisation of current regulations could provide more flexibility for part time youth employment (eg less than the minimum 3 hour stretch), providing workplace “tasting” as an encouragement to career choice. Provision for migrant workers on dairy farms is also an essential component in the farm labour mix, given the depletion of skills in this sector as a whole, and the lead time it will take to rebuild the farm workforce. These are broader workforce strategies that the Government should already be addressing.

Succession planning is a critical issue for farming generally, including dairy farming. The farm workforce is ageing, and the operating environment is not encouraging younger people to enter the industry as farm owners or farm employees. However there are excellent possibilities for restructuring the industry to provide attractive employment and enterprise conditions, given appropriate reforms. It will then be appropriate to fashion incentives for younger people to buy a stake in dairy properties as they take over the reins of farming from retiring farmers. New structures for rental purchase and shared equity should be assessed as possible mechanisms.

Recommendation 9: As part of the current rural reconstruction financial initiative, the taskforce should examine new tenure forms for encouraging young people into farming, with support from the banking sector.

TOR7 The effectiveness of regulations affecting the agriculture sector, including the extent to which regulations promote or retard competition, investment and private sector-led growth

Dairy farming is one of the most regulated farming activities in Australia, and there is an excellent case for regulatory reform of this industry sector. There are numerous statutory bodies which appear to have a vested interest in maintaining and adding to the regulatory regime, impeding the cost effectiveness of milk production.

Examples have been given of regulations that require review in the areas of processing milk for farmers to sell direct from farms, and restrictive regulation and licensing that limits participation in export of primary produce. It is likely that others would come to light in any regulatory review process.

Recommendation 10: The Australian Government should commission a thorough regulatory review of the dairy industry and related industries, and remove all regulations that are unjustified or which favour the commercial operations of particular companies. The review process should be preceded by an inquiry which invites submissions reporting misuse of regulations, inappropriate or outdated regulations, and restrictive practices arising from regulations, with a view to enhancing industry competitiveness.

TOR8 Opportunities for enhancing agricultural exports and new market access

There are significant opportunities for Australia to expand its exports of dairy products, and to benefit from the booming consumer demand in Asia (particularly). This requires a concerted effort by Government and industry working together to secure new international markets, and to increase Australia's international competitiveness.

To date, Australia has focused its exports on the Japanese market, particularly in relation to cheese. Japan takes around 50% of Australia's cheese exports, worth over $500M pa. The problems with reliance on this market are:

- the Japanese market is static, with little growth in demand
- the lack of a Free Trade Agreement with Japan means that around $200M per annum is expended on import tariffs and other import costs
- the US group Co-operatives Working Together (CWT) utilises a disguised subsidy framework for expanding US dairy exports, and is now targeting Japan among other markets.

New Zealand has been much more successful than Australia in penetrating new and expanding markets, particularly China. New Zealand provides almost all of China's whole milk powder imports, and around 44% of imported cheese. This is assisted by the established Free Trade Agreement between New Zealand and China which effectively reduces import tariffs from 10% to 5%. New Zealand processor Fonterra has established production plants in China, as well as marketing networks in that country.

Australia's new Free Trade Agreements with Malaysia and South Korea offer new opportunities for market penetration in those countries, particularly in relation to cheese, butter and infant formula. Government support is needed to make sure that these benefits are realised, and to establish further Free Trade Agreements with other countries that have expanding dairy markets.

Australia's potential as a dairy exporter is well illustrated by the substantial interest from overseas investors in acquiring dairy farms and processing plant. Australian dairy infrastructure appears to be undervalued in terms of the global market. The global squeeze on supplies has produced increased milk prices in many other producer countries, which are not reflected in the Australian price structure. This makes Australian dairy products highly competitive based on price, even with the high Australian dollar. While this is partly because dairy farmers are effectively subsidising the low prices of dairy products, it is evident that our industry could be highly competitive even with a better price paid to farmers for their milk.

As explained earlier, none of the potential export markets can be secured in a situation of declining milk supplies, produced by unsustainable milk prices. At some point dairy processors will realise this, but at present this appears not to be the case. Most of the major processors have significant expansion plans involving large capital investments (reducing their capacity to increase payments to farmers) which are based on securing at least 1B litres extra per year rather than the likely annual reduction of 0.5-1B litres. The consequences of this over-reach have yet to be seen, but some analysts are predicting imminent disaster (Barry Crumps, December 2013).

Recommendation 11: The Australian Government should prioritise dairy export expansion in the growing markets of Asia as a replacement for reliance on the Japanese market, targeting Free Trade Agreements as a vehicle for achieving competitive advantage. This needs to complement other strategies for domestic industry expansion based on growth of milk supply.

TOR9 The effectiveness and economic benefits of existing incentives for investment and job creation in the agriculture sector

At present there appears to be a plethora of data but very little analysis about the workings of the dairy industry as a whole, and particularly the value chain involved in the production of dairy based foodstuffs and other by-products. Before creating incentives for investment, it would be desirable for all players to have a much better understanding of how the industry works as whole, starting with the cows and ending with the sale of dairy product, then examining how the industry earnings are distributed. There should be sufficient data available to do this relatively quickly, and it is surprising that Dairy Australia or any other industry body have seemingly not attempted it.

An analysis of the industry can reveal the wasted resources and opportunities for innovation that can provide incentives for industry investment and participation, and the industry restructuring that is necessary to maximise cost efficiencies. It can indicate how some stakeholders can share resources in becoming more efficient, and others need assistance in fulfilling their essential roles. The appropriate role of industry bodies in shaping the industry may then be much clearer.

What would be even better would be to use this analysis as the basis for developing a strategic plan for the dairy industry. Again, the industry bodies appear to have failed to provide such leadership, instead setting targets without realistic strategies, and then consistently failing to achieve them. Farmers would of course have an important part to play in developing a national strategy, and one of its principal aims should be to establish dairy farming on a sustainable footing as the foundation for the industry as a whole.

At the marketing and distribution end of the value chain, there is an important part to play for governments in paving the way for new export contracts through trade agreements, trade fairs and facilitation of joint ventures. This needs to be well targeted in terms of establishing markets where Australia has a competitive advantage (possibly South Korea and Malaysia in the immediate future) and recognising the possibilities for incremental growth in Australia's production capacity over time.

Farmer Power would not normally advocate for planning rather than action, but the time does seem to be right for an industry rethink, and its restructuring needs a clear strategic rationale. It would be important that the national plan is a plan for real action, and that there is a clear commitment to implementation. We believe such an approach would deliver excellent value in terms of improved industry performance, including jobs and wealth creation.

Recommendation 12: The Australian Government should commission preparation of a dairy industry analysis as the basis for a national strategic/action plan, based on data already available and with the active participation of a dairy farmers' taskforce. The plan should be put in place with negotiated stakeholder commitments for implementation before the end of 2014.

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