



# LEGISLATIVE COUNCIL

## SELECT COMMITTEE ON GROCERY PRICING IN SOUTH AUSTRALIA

Held at: The Oak Tree Room, The Barn, Glenelg River Road, Mount Gambier

Friday, 6 September 2024 at 9:05am

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## WITNESSES:

ELFERINK, JOHN, Staff, South Australian Dairyfarmers' Association

HAMILTON, GRAEME, Member, South Australian Dairyfarmers' Association

450 The CHAIRPERSON: We would like to acknowledge the land we meet on today is the traditional lands of the Boandik people and we respect their spiritual relationship with their country. We also acknowledge the Boandik people as the traditional custodians of the Mount Gambier region and that their cultural and heritage beliefs are still as important to the living Boandik people today.

Gentlemen, welcome. My name is Robert Simms. I am the Chair of the committee. The Legislative Council has given the authority for this committee to hold public meetings. A transcript of your evidence today will be forwarded to you for your examination for any clerical corrections. Should you wish at any time to present confidential evidence to the committee, please indicate and the committee will consider your request.

Parliamentary privilege is accorded to all evidence presented to a select committee. However, witnesses should be aware that privilege does not extend to statements made outside this meeting. All persons, including members of the media, are reminded that the same rules apply as in the reporting of parliament. Obviously, you are aware that the ABC are recording today.

Before we begin, I will introduce to you the members of the committee. To my right, I have the Hon. Mira El Dannawi and to my left the Hon. Ben Hood and the Hon. Jing Lee. We are also joined here today by some staff from Parliament House. We have with us Leslie Guy, the secretary, and Dr Margaret Robinson. We also have Charles with us, and Birgitt and Lucy from Hansard. That has tested my name recognition skills. I have done a good job so far this morning.

Thank you very much for coming to share your evidence with us. In terms of the format, we will open it up to you if you would like to make some general statements and then I will ask some questions of you from the Chair and then I will open it up to the broader committee for their questions. Over to you.

Mr HAMILTON: I will begin. Thank you very much to committee members and staff for convening in this region and enabling us to present some thoughts. I am a member of the South Australian Dairyfarmers' Association (SADA) and am joined by the association's policy officer, John Elferink.

The dairy industry feels it can speak about retail pricing from some experience and this is not the first inquiry into supermarket pricing. The federal government conducted a similar inquiry about five years ago to discover the situation which allowed the dollar-a-litre milk phenomenon to occur. The ACCC found the real problem lay within our own industry. One of our leading identities was found to have misled shareholders about company matters and he offered packaged milk to supermarkets at unsustainably low prices, causing financial hardship for many farmers. The report also found that supermarkets only sold milk below wholesale cost price on two short occasions.

We remain totally opposed to the use of loss-leading products to lure consumers to the rear of the shop in the hope that they will buy other products along the way. All products should be sold on their own merit and for prices which reflect the actual cost of placing it on the shelf. Lowest supermarket prices come at a cost to someone and that someone is usually the farmer at the end of the line, with nowhere else to pass the cost increases on.

Another factor at the time were the farmer to processor supply agreements, which were written very much to the benefit of the milk processors, so much so that if the company's milk price offer at the beginning of the financial year was found to be overly optimistic, they could reduce the milk price and compel farmers to make up any financial losses suffered by the company.

Thankfully, this led to the implementation of our farmgate milk price mandatory code of conduct which rebalanced the negotiating power between farmers and processors.

SADA was heavily involved in implementing the mandatory code and has strengthened its presence in this arena by developing distributed ledger or block chain technology to monitor production costs from farm to retail shelf. John will provide more detail on this topic in a few moments.

Recent retail dairy price increases are covering some of the losses from those darker years and reflect increasing supply chain costs rather than being solely caused by higher supermarket margins. We note that while supermarkets have very high monetary turnovers, their profitability measured against turnover is often only 3 per cent per annum, not nearly as high as Australian companies involved in industries like banking and mining, for example.

We also highlight the fact that certainty of supply for grocery items in Australia has never been more reliable than it is today. This country has very robust supply chains from the farm to supermarket, including our freight and processing facilities. Operators utilise very reliable systems and equipment because breakdowns and downgraded product are both very expensive events. The consumer is the beneficiary of this reliability.

Government policy can also affect the cost and supply of grocery items. The Lower Limestone Coast Water Allocation Plan is presently undergoing a scheduled review, and decisions implemented by the Department for Environment and Water at the conclusion of this process have the potential to affect the supply and price of groceries to South Australian consumers.

About 60 per cent of South Australia's milk is produced in this region, not to mention the beef, lamb, potatoes and grains sourced here. If the decisions implemented by DEW increase the risk of higher productions then the cost of grocery items will increase as a result. We trust that changes to the water allocation plan will wisely balance the dietary and economic needs of society with the environmental considerations.

One criticism we do have concerns supermarket price movements, particularly when commodities like milk, beef and lamb change. Our perception is that shelf prices go up too quickly when the commodity price increases but when the commodity price declines the shelf price does not react with the same rapidity.

Another criticism is the readiness of supermarkets to displace domestically produced grocery items with cheaper imported substitutes. Frequently, these products are not produced to the same standard as Australian grown and in most cases the people employed in the production do not receive pay rates comparable to Australian employees, even in countries we regard as close allies.

In recent years, supermarkets have been actively procuring milk supply direct from farmers, and those involved usually find the relationships professional. Initially, this milk was processed under contract by other milk companies but now the supermarkets are acquiring their own processing, storage and distribution facilities. We will watch this new phase with interest, noting that similar arrangements have worked successfully with other commodities for many years.

We notice that the terms of reference of this inquiry included the notion that small farmers should have greater ability to place items on supermarket shelves. We recognise the substantial cost of acquiring supermarket shelf space and that to ameliorate that cost the shelf must be kept full of high-turnover product. This is something small producers will always struggle to manage successfully.

Dairy farmers are always seeking long-term relationships with commodity purchasers, which provide economically sustainable and stable pricing for their product. The problem for farmers, processors and supermarkets alike continues to be shrinking financial margins. In recent decades, a great many have ceased operation, leaving others to expand, fill the void and gain greater efficiencies, hence the landscape now has larger farms, larger processors and fewer supermarkets.

Front of mind for most farmers continues to be a viable future for their families, something unachievable had they not expanded. Again, the consumer is the beneficiary of more reliable product supply, more consistent quality and limited price increases. Thank you for listening and I will allow John now to expand on a few topics. We welcome your questions after his presentation.

451 The CHAIRPERSON: Thanks, Mr Hamilton. Over to you, Mr Elferink.

The Hon. J. ELFERINK: Thank you very much. We put a lot of thought into this inquiry. I won't say we were concerned, but we were mindful of some of the drivers that drive supermarket shelf prices. If you consider the observations made by Allan Fels, the former chairman of the ACCC who ultimately did a review that was mentioned in the process of establishing this inquiry, it is informative in a number of important ways. In his work he also made some observations in relation to the conduct of supermarkets and how they establish their pricing models.

I agree completely with Graeme in terms of the margins on which these supermarkets operate. I think you, Chair, said that they were making a motza in your opening speech to the parliament, and certainly over a billion dollars sounds like a motza, but when you consider the turnover of Coles, in the case of \$43 billion, it works out at about the 3 per cent margin Graeme referred to. They are some pretty marginal numbers if you look at the market cap of a number of banks and their turnovers. There are other companies that run much higher margins.

The other difficulty with looking at a single annual report is that you are seeing one frame in a whole movie. One could be forgiven for thinking that Qantas, for argument's sake, was a dead duck financially for a number of years because it ran losses, but what it was actually doing was spending a whole bunch of money buying new aircraft so it could continue to make profits into the future. Looking at one annual report with a loss or a big result does not give you a complete picture of a company, particularly a company that is 100 years old.

That is one of the challenges the committee will face: is it a motza this year and, if it is a motza, what does it look like compared with other years? Supermarkets have always been in the crosshairs. There is no doubt that, when the \$1 milk controversy came into existence, it was the supermarkets that were firmly in the crosshairs. The ACCC zeroed in on the supermarkets and their purchasing conduct. It was a large surprise when, at the end of that inquiry, the supermarkets I would not say were completely exonerated but were substantially absolved of responsibility for the \$1 milk issue in the dairy industry because it was generated by the processors, which are the middle man between the farmer and the supermarket. The supply chain within the dairy system is: farmer, processor, supermarket.

The supermarkets had determined—and it is my opinion that they had determined—to run a loss leader with the \$1 milk. However, because of conduct of what was then Murray Goulburn the company, as opposed to Murray Goulburn the collective—so they had transitioned from a farmers' cooperative to a company—misleading statements were made by Gary Helou, the CEO of Murray Goulburn, and ultimately he was held accountable for his criminal conduct.

Murray Goulburn used to sit, if you can imagine this, like a cannonball in the middle of a trampoline, and all milk prices altered around what Murray Goulburn said. The consequence was that, when Murray Goulburn dissolved, a lot of those other processors, which ordered around Murray Goulburn, set their own prices and then as a consequence enormous downward pressure was forced on the farm gate. In the death knell of Murray Goulburn it was trying its hardest to convince supermarkets that they could make a profit on \$1 milk.

The net result was that you had other processors who were sending bills to farmers to recover the shortfall in cost projection. In some instances farmers were getting accounts for a quarter of a million dollars that they owed their processor, because the processor had done an estimate and paid on the estimate. When the estimate came in low they sent the bill to the farmer—that was part of the outrageous contracting behaviour—at a time when farmers were earning about \$2 an hour and their milk was being sold on the shop shelf at less than the price of bottled water, substantially less.

The ACCC ended up saying that it was not the supermarkets, it was the processors, and as a consequence of that the Dairy Industry Code was established, but the Dairy Industry Code is not a price-setting mechanism and we do not advocate for a price-setting mechanism. The Dairy Industry Code is simply a vehicle by which the contracting parties can negotiate with each other on an even playing field.

Take a company like Saputo or Lactalis. I think Lactalis' annual report said that they had a turnover of about €\$6 billion. When they are negotiating with a farmer with 250 cows, that

immediately implies there might be a distorted contracting environment. So the purpose of the code was to bring that contracting environment into a level pegging environment. The challenge with that is that fair prices started to be paid by processors to farmers, which meant the processors had to pay more for milk, which ultimately meant it was passed onto the customer. The challenge for the supermarkets, or for this committee in looking at the supermarkets, is to determine if there is any unfair play in that supply chain.

Part of the reason that we do the SADA Fresh milk product and the SADA Fresh cheese product into Coles is so that we can participate in the supply chain, and we can figure out whether or not we are being misled or duped by Coles in the way that it deals with its products. Recently, we had to put up our prices. The number of hoops you have to jump through to satisfy Coles that you are not profiteering yourself are actually quite substantial. There is a fair amount of negotiation that has to happen before they will allow a price increase to occur. The impression that we get at SADA is that Coles is very mindful of the price of the product on their shop shelf, and they are very mindful of the scrutiny that they have been subject to, à la committees of this nature.

452 The CHAIRPERSON: Can I just ask you on that point, Mr Elferink, what is the discrepancy between the price that is paid at the supermarket by the consumer versus the processing price that you are talking about? You are saying that, if there is a circumstance where the price of milk has to be increased, Coles are concerned and ask you to justify why that might be the case, but how much of a mark-up is there then when it gets to the supermarket shelf?

The Hon. J. ELFERINK: The challenge for us, of course, is that we are subject to our contractual arrangements with Coles. To cut a long story short, they make—and as a result of privilege I can do this—about 30 per cent, which is about what you would expect. That is also their overheads. They have staff costs, etc., on our cheese product going through the door. That is not unusual in the retail environment, and they have their own costs.

I am enlivened by your terms of reference (g), which particularly looks at how can you as an external observer look in and say, 'Alright, this is actually fair.' Fels, in his report on page 55, makes a similar observations. Fels will encourage you to go down the pathway of regulatory imposition in terms of overlooking how those prices are arrived at, because I suspect that is Mr Fels' experience. That is the only way he can look—by setting the regulatory levers in such a position that they then have to then disclose what they are doing.

The problem with that is that such a regulatory imposition will also be imposed on processors and ultimately farmers. At the moment, satisfying regulation alone imposes a substantial cost on farmers. With federal government regulation, coupled with state government regulation/expectations, coupled with local government, a small farm of 400 cows will have somebody almost tied up full-time satisfying the requirements of regulation.

The EPA, for argument's sake, wants certain standards to be met. Their legislation says that compliance with their act means reasonable and practical solutions have to be found for environmental protection—no problem with that. When you actually talk to the EPA, all the dials are set to a zero risk or lowest possible risk threshold, which means that the cost of compliance then goes up for threat level which is potentially not that high.

Regulation is another imposition of that nature on farmers. That cost will ultimately be borne by the customer. Farmers nor processors nor supermarkets are registered charities, as a general proposition. Farmers in particular are there to make money so that they can look after their families, etc. Fels' solution is more regulation. In his report, he says:

Enhancing transparency across the supply chain is crucial. This could be achieved through initiatives like mandatory reporting of pricing structures and margins by supermarkets and processors (subject to any competition concerns) and the development of platforms that provide farmers with more information on market trends and pricing.

Paid for by who? The customer.

453 The CHAIRPERSON: You wouldn't think the supermarkets would have capacity to absorb that?

The Hon. J. ELFERINK: Given their margins, I think they are already living on a 3 per cent margin, once you consider that they had a \$1 billion or \$1.5 billion profit in the year, to which you referred in your opening statements in December last year to the house.

Coles has 22 million customers come into their shops every week, the whole population of Australia. In the context of those numbers and the \$43 billion of turnover they report, that actually carries a certain level of vulnerability to it. I know I am sounding like I am defending the supermarkets, but our experience of the supermarkets is that they really would like to have cheaper prices for their customers because they are in a highly competitive market with Woolworths. I have seen no evidence of collusion—none. All the evidence that we have through the processes that we have is that every time we try to move our prices, because we have costs, they actually make it difficult for us—not impossible, but difficult—because they want to keep downward pressure on us as well in the processing environment.

454 The Hon. B.R. HOOD: Can you expand on how they make it difficult for you?

The Hon. J. ELFERINK: Sure. Let's say we suddenly realise that because the cost of doing business has gone up, also largely because the inflationary pressure of printing a lot of money at a federal level has created inflationary pressure, we then have to respond to that because we produce a cheese product which we send into Coles. So we contact Coles and then they have a spreadsheet which they ask us to fill out and there are a number of details in that spreadsheet where we have to tick a box to demonstrate that the cost of our doing business is actually the cost that has been imposed upon us, not just us upping the price because we had the opportunity to do so.

Our profit margin, which is really lean on our cheese product—and I mean really lean—cannot be, under the contractual arrangements, bumped up by us unless we justify the cost imposts that we have to bear that are putting upward pressure on the price.

455 The Hon. B.R. HOOD: Do you find that that's fair?

The Hon. J. ELFERINK: I think it's the way you have to go through business with somebody, or an organisation that is very used to being examined in the public domain. They are hypersensitive to being examined and that then reflects in the way that they examine us. Every time we say to them our cost of doing business has gone up, 'Oh yes, prove it.'

456 The Hon. B.R. HOOD: Again to that question, do you think that that belies a power imbalance because there are only two major supermarkets in Australia?

The Hon. J. ELFERINK: There is always a power imbalance when you are dealing with an organisation the size of Coles, Woolworths or Aldi—or even Drakes for that matter—but that power imbalance does not become manifest, in my opinion, in unfair practices. We haven't seen it. It does become manifest in a high level of caution on the part of the supermarkets to make sure that if a price goes up on their shelf they can actually justify it.

I do want to follow through with what I was referring to in relation to Dr Fels, because emerging technologies are something that we are very interested in at SADA and the emerging technologies that we are currently doing research in is traceability-based research, for a variety of reasons. There is no other industry like the dairy industry when it comes to the harvesting of information. We see our cows, in most instances, at least twice a day and in many instances we have cows that have a collar on them and they walk past a sensor, so even if they are in a free-stall barn, or if they are coming in off the paddocks and they are going into a rotary, particularly with the robotic systems now, huge amounts of information are harvested off those cows—tonnes of it.

We can track how often a cow chews per minute, how many hours a day its head is down, how many hours a day it spends chewing its cud. That information harvested can be then placed onto a distributed ledger. This emerging distributed ledger technology—you will know it as blockchain in the general rule—enables us to harvest huge amounts of information and store it along the supply chain. The research project that we are doing at the moment enables us to track milk as it moves through the supply chain as it gets converted into other products, and enables oversight of what happens in that supply chain.

It's not a huge leap to also build into that sort of technology price monitoring. Rather than imposing a regulatory environment which then means somebody has to be paid to sit down and

tick all the boxes and fill out the forms, there is emerging technology which is very quickly proving itself up, where you can actually harvest this information straight off the system itself where an impassionate observer can sit down, open up the blockchain, read what's happening and see things like price movements through that system.

That will not require legislation of the nature recommended by Allan Fels. It will be there, available for anybody to look who has the right level of access. This technology is being explored and developed in a number of places. We are one of the projects that are doing research in this space. We expect, on the basis of our alpha and currently beta trial—one of our trial partners is Woolworths, by way of declaration—that we will be able to harvest huge amounts of information, not only the linear components of the chain but also the things that surround the litre of milk.

So, eventually, the light on the hill is that somebody who is buying a block of cheese at Marks and Spencer in London from South Australian milk will not only be able to trace the milk all the way back through the system but will be able to see the carbon footprint of that block of milk, what was the temperature of that block of milk in the hold of which ship from across the equator on what day. All of that information can be loaded onto a blockchain, including costs.

If you are going to, as a committee, turn your mind to how you oversight supply chains in terms of the cost imposts, I would be looking at that far more closely than regulatory solutions, which are just going to increase the cost burdens on the production system.

457 The CHAIRPERSON: That's very interesting, thank you. Who would pay for that technology, in your mind?

The Hon. J. ELFERINK: The technology itself is, depending on the blockchain you are using, generally open source. But our trial program uses a system called HBAR on the Hedera Hashgraph system. If you take the time to look at Hedera Hashgraph as a blockchain, you will see a governing council on its website. Its governing council is some small companies that you may have heard of: IBM, Google, Boeing, etc. All of these companies have a vital interest in understanding their supply chain and being able to oversight their supply chain.

The execution of these points of information or smart contracts on the chain are actually really cheap. The execution of a single smart contract on the HBAR block chain is one 10,000<sup>th</sup> of a US cent. So if you have a smart contract that, say, has a hundred elements in it, then that contract executes for one hundredth of a US cent, and there it is, information available to anybody who needs to examine it because the nature of these chains is that they are embedded in the internet as a distributed ledger and it is a source of truth, which is unalterable by any third party, which is why they work.

458 The CHAIRPERSON: Mr Elferink, you mentioned your business relationship with Coles and Woolworths. Do you have relationships with other players as well, or are they kind of the only two options that you have in the market?

The Hon. J. ELFERINK: As part of the South Australian Dairy Industry Action Plan, which SADA advances and promoted and has been supported to the point where it's been adopted essentially as South Australian government policy—the second iteration of it was launched by the Premier a number of months ago—we seek to develop partnerships across the supply chain.

The reason we do that—without breaching Australia's competition laws, obviously—is that if you look at other jurisdictions, the relationships between farmers and processors are often rocky and brittle. We have taken great care to make sure that those relationships are as cooperative as they possibly could be. That doesn't mean we engage in price setting or anything else like that, but we have a close relationship so that government, processors, supermarkets and farmers are all singing off the same song sheet. That positions us as a jurisdiction to engage the rest of the world with products that go through a system that sees our premium product front and centre in people's minds.

459 The CHAIRPERSON: What does that look like in practical terms, in terms of the development of relationships along the supply chain, bearing in mind that I certainly don't have expertise in your field and I am keen to understand what that looks like?

The Hon. J. ELFERINK: What it looks like is that when we do something like a blockchain research project, we can knock on the doors of Woolworths and we can knock on the

doors of the Fleurieu Milk Company—who is our partner in that particular project—and we can knock on the doors of a number of farmers and say, 'We need to look right inside your business and we actually want to put monitoring equipment inside your business so that we can inform the information we collect on our distributed ledger effectively.' In most places, businesses will be highly resistant to that sort of import, particularly from a farmer representative organisation, because of the level of caution that they will have about exposing themselves.

What we're actually finding is now that we have the Dairy Industry Action Plan in place, for example, the Fleurieu Milk Company said, 'Yes, by all means put the monitors in.' Equally, the farms also have electronic monitors and that information is now available to the Fleurieu Milk Company so they can see what's happening on farm. That is a level of trust. So a bunch of confidential information finds its way into the supply chain, which is trusted, and that level of trust is respected across the supply chain as a direct result of the Dairy Industry Action Plan.

As South Australia, we can't compete on a commodity space, generally speaking, in the international marketplace. If we produce a pea, Australia produces a tennis ball and New Zealand produces a basketball. So if we can't play in the commodity space, what can we do? We can do premium. So what makes a product more premium? The knowledge of what's in that product and everything that surrounds that product: was there any child labour used in the production of this block of cheese, what were the biosecurity standards that were applied, what was the carbon footprint, etc., etc. All of that information then creates a product which is premium not just because of what's in the product, inside the plastic wrapper, but all of the reputational value that surrounds it.

Oversight of pricing through that supply chain, demonstrating legitimacy every step of the way embedded on the distributed ledger, is a much more practical solution for what you're trying to achieve than more regulation.

460 The CHAIRPERSON: Who funds the work of the association? Is it through dairy farmers?

The Hon. J. ELFERINK: Members pay—

Mr HAMILTON: An annual fee.

The Hon. J. ELFERINK: —an annual fee which is fairly expensive. We also do a lot of work on a grant basis, receiving grants, doing the sort of research project we're doing. SADA has deliberately chosen not to be just a standard representative organisation that goes, 'We need this, we need that,' we want to be a solution provider. That means that SADA has to demonstrate a level of imagination which is not normally ascribed to representative organisations, and that's why we look at things like the technology that we're working on because we see that as a better vehicle for solution than just the imposition of more rules.

461 The Hon. B.R. HOOD: Mr Elferink, I want to go back to the questions I was asking around the justification of input costs to supermarkets. We've heard evidence in this committee that should a business in other products find efficiencies within their business, such as upgrading of machinery and whatnot, supermarkets or category buyers have put pressure on them to lower the price that they're selling to the supermarket. You have to justify your input costs for the supermarkets. Do you have to justify efficiencies as well?

The Hon. J. ELFERINK: No. The experience I have had is that, if we find an efficiency, that's good luck for us. We start with a price of supply to the supermarket. Once that contract is locked in for price of supply, if we can suddenly, through the waving of a magic wand, produce the cheese at half the cost, good luck to us. What we can't do is up the cost of delivery on an agreed price in circumstances other than a legitimate cost increase because our costs have increased. So, if there is an efficiency to be found in our system, good luck to us, but with something like dairy or cheese manufacture most of the efficiencies have already been discovered I suspect.

462 The Hon. B.R. HOOD: You have found them, that's good. I will just go to one question with regard to blockchain and that traceability and that providence question. We also have heard evidence that in some European countries supermarkets must declare the buy price alongside of the price that they sell. We are talking about regulation being a cost borne by the customer, but, should we have a distributed ledger, a blockchain, across all commodities or all produce that is sold



in the supermarket, would you think that a supermarket having to declare a buy price would be a helpful thing?

The Hon. J. ELFERINK: The difficulty with that and my instinctive response—and I will deal with that as a question without notice, if you like—is that, as long as it's not an oversimplification of the challenge that the supermarket is facing, a supermarket will have its own costs, labour, energy, etc. If you look at the price of energy in Australia in the last 10 years, it has doubled or thereabouts, and more recently we have seen another spike, domestic as well as commercial, that purchasers have had to incur.

A straight up and down 'this is our buy price, this is our sell price' may not reflect the nuances of the cost of taking it from the processor's loading dock to the checkout and I would suggest that you would have to examine those potentialities more closely before you could just arbitrarily wave the wand and say it is so.

463 The Hon. B.R. HOOD: Thank you, that's good feedback. Graeme to you. John spoke about the cost of compliance for the EPA and the regulation and compliance that they put upon the dairy sector. I was very interested to hear that you referenced the Lower Limestone Coast Water Allocation Plan and I would be keen to hear from a South Australian dairy association perspective what could be the impost of water and water security issues on grocery prices coming from the dairy sector in particular.

Mr HAMILTON: I probably can't put dollar values on those things, but I can say that for the farms that are running with an amount of water if, just say, there was a reduction of 10 per cent in the amount of water available on a farm each year then one of a couple of things has to happen. Firstly, some cows could be sold off because there is now no longer the amount of food there and irrigation doubles the productivity of a hectare of land, so some cows would have to be lost from the system somewhere, so that's an overall reduction for the region, for the state.

It's also very difficult for the farmer because, if you take out those cows, he/she has commitments to financial institutions and others and fixed costs that now no longer can be met so it has just tipped him into the more marginal category from what he was.

On the other hand, they could go and buy, say, lucerne hay, which is high quality and could come from Tatiara maybe, but there is a new cost and we have infrastructure already on the farm—irrigation, pumps and all those things—that is now partially idle, somehow or other, and we are buying in this feed to do what we previously did. So you are starting to put higher risk because if in a year, when that lucerne hay is harder to procure, suddenly my end-of-year balance, my profit or loss, is not looking so good anymore.

The bigger that reduction in water available is to the farm, then that's going to heighten all those costs, and of course it's going to stymie any new growth and development that might happen in the region. The water will be used to its maximum efficiency, and there will be no more available to new players who might want to come in. So they are some of the angles that immediately spring to mind, but greater risk for the farmer means that they need greater margin to cover those risks and then that greater risk passes on through the price of groceries, etc.

464 The Hon. B.R. HOOD: I think to John's point, just to link it back to when we were talking about declaring a buy price for a supermarket, it may be simplifying the matter too much to say, 'This is what our buy price is, this is what we are selling it to you for, but we don't understand the quantum of everything that goes into getting to that price.' From a water perspective, on the face of it it might seem that we are doing a wonderful thing if we are doing a 10 per cent reduction and giving that back to the environment, but ultimately that can have some quite serious effects in terms of economic angles for people raising the cost of groceries when we are already in in a cost-of-living crisis. There are perverse outcomes with regard to water availability.

Mr HAMILTON: For some operator who was running really close to the wind, then they would probably say, 'Look, this is just the straw that broke the camel's back. I will pull out.' Neighbours and so forth will come in and pick up the pieces and make what they will of it, but overall the region is still suffering. So individual farms will have to assess their viability and others will have to try and make the best of what's left.

465 The Hon. B.R. HOOD: Graeme, the reason I do ask this question is because we have heard some evidence from charities here in the Limestone Coast talking about how they have just seen an increase in people having to come to them to be able to get food because they have to make a choice between heat and eat: heating their home or eating. We could see a serious issue in which there are job losses across the South-East when we are talking about water availability for our primary producers—and not just dairy but we are talking about horticulture and forestry as well.

Mr HAMILTON: Yes, exactly. It all has to be really carefully considered. It's not a very easy equation to come to a definite answer on.

466 The Hon. B.R. HOOD: No, and I think as John put, these are all intrinsically linked. If we are talking about grocery prices, we still need to consider all these other things such as input costs, such as efficiencies and also the availability of water. That all adds up to what we are seeing from a supermarket point of view.

Mr HAMILTON: When the farmers have to go into outside sources of forage, then that increases the risks in a drought. You say when the Tatiara doesn't produce as well, then the price of that commodity is going to go up and then their costs are unexpectedly going to rise. So it's just adding more vulnerability and more risk to the whole supply chain, all the way through.

467 The Hon. B.R. HOOD: Thank you, Graeme.

468 The CHAIRPERSON: The Hon. Jing Lee.

469 The Hon. J.S. LEE: Thank you very much, Chair. Thank you Graeme and John for joining us this morning for your very wonderful presentation, for sharing your experience and the point of view of industry. For the record, can you actually provide the committee with the size of your membership organisation? You talk about partnership with the supply chain. Within your Dairyfarmers' Association, do you have representation from the farmers, the processors and perhaps even the other supply chain partners?

The Hon. J. ELFERINK: Our membership is about half of the number of actual dairies in South Australia, so about 180 dairies. Our membership is about 90. Of that membership, that represents about 80 per cent of the milk supply. So the larger farmers are certainly our members. There are some dairy farmers who are on the smaller end of the scale of 150 to 160 cows who don't particularly want to get involved in agripolitics, so they keep themselves apart.

We have associate memberships with a couple of processors, so that they, as part of their relationship-building, hold associate memberships. I think Beston has one. I could stand corrected on that. We welcome that, because that provides input from them as well. To cut a long story short, we maintain as high a possible quality of communication with processors as we can, so that they get an opportunity to explain what's going on in their minds and their challenges along the pathway.

Our involvement in the supply chain as a partial processor ourselves, helps us to inform ourselves as to whether or not they are being upright with us or not, or whether they are just gilding the lily a little bit. As a general proposition, they have been quite honest with us when issues come up. Sometimes those conversations can be very frank and forthright. That's fine. We're happy with that. We would expect it, but, ultimately, the relationship is still covered by the Dairy Industry Action Plan, which seeks to develop an industry in South Australia that will eventually provide for premium export so that South Australia becomes, in the international community, to dairy what Barossa is to wine.

470 The Hon. J.S. LEE: Wonderful. With the Dairy Industry Action Plan, what component of the action plan is related to—obviously it is related to being very competitive internationally, but pricing of products and services will be part of the discussion. Which component of the action plan actually addresses those issues relating to pricing?

The Hon. J. ELFERINK: This is why we worked for a premium product, because our pricing structures are such, as a small jurisdiction—as I said, we can't play in the commodity space—what we want to demonstrate is quality over quantity, so to speak. If we try to compete in the commodity space—and there is an element that does in South Australia operate in the commodity space, so you've got dryers which produce powdered milk which is sent to Vietnam, not far from

here. That's terrific, that's commodity, but the vast majority of what we do is premium, and so what we will be choosing to pursue, particularly in export markets, is premium, so the focus will be less on price and more on things like quality, particularly those elements that surround the package rather than just what's in the package as I described before.

471 The Hon. M. EL DANNAWI: Thank you both for your submission today. My question is a follow-up from this conversation. I may have witnessed as a person who goes grocery shopping, that sometimes—I know you talked about the quality, and that push to have a product that can compete perhaps internationally, but do you feel like your average person who goes to the supermarket is more looking into the price of the product? What are your views?

The Hon. J. ELFERINK: The short answer is it depends on the customer. Our cheese product sells for \$6.50 for 200 grams, for our cheddar and our gouda product on the shop shelf in Coles. It competes directly with a \$10 a kilo block from New Zealand. The person who is going into the supermarket is presented with a number of options. They can either choose a more refined product—top-shelf product, for the lack of a better expression—or they can go for the bulk product. I can't imagine, knowing the system as I do, how on earth the \$10 one-kilo block of cheese actually arrives on the shop shelf at a profit for anyone.

It actually comes from New Zealand milk, which is substantially cheaper than Australian milk because of cost of production. They bring it across the ditch—I think it is called Mainland cheese—to where it is sold. If a customer wants to buy a cheaper cheese, I can tell you now that buying it at \$10 a kilo or \$12 a kilo they are picking up an absolute bargain because we, as the South Australian Dairyfarmers' Association, couldn't hope to produce a block of cheese at that price. The last time we calculated a one-kilo block of cheese we came in at \$23 retail. Compare that to a \$12 block from New Zealand. We would have to run at a loss if we did it any tighter, so we just didn't choose to compete in that environment.

472 The Hon. B.R. HOOD: As a supplementary on that, John, why is there a significant difference between the cost of production in New Zealand and Australia?

The Hon. J. ELFERINK: Because New Zealand farmers are being paid a lot less. They also have a higher concentration—remember I said pea, tennis balls, basketball. The cost of production in a basketball environment does become—it is just the size of the ability to produce means their cost of production overall becomes lower per unit cost.

Mr HAMILTON: New Zealand does have some quite superior soils, especially in the Waikato region—really deep topsoils, a metre deep and things like that, free drained, very fertile, able to hold nutrient. They also have generally more regular rainfall, so that negates the need for the irrigation and things like that, whereas here in this region we have shallow soils and in two or three days with the right weather it cannot store moisture. But we can make them work given this wonderful resource we have underneath us. We can make that work.

It is the natural resources in New Zealand. But, of course, it is a country with limited area. There isn't much room for expansion in that country now, and there are very few arable areas. It's very expensive for them to feed grains to their cattle, for instance, because they don't have arable area to grow that. It has to come from Western Australia in containers. This is just the way it falls.

473 The Hon. B.R. HOOD: The reason I ask is that I was just wondering if there were government levers that were being pulled that were changing the cost of production equation.

Mr HAMILTON: How they land that cheese here for that price we don't—

474 The Hon. B.R. HOOD: Yes, I can't get my head around it.

The Hon. J. ELFERINK: Fonterra, which in Australia is a publicly listed company, over there is a cooperative. There may be some margins in there. Certainly, economies of scale I suspect would be operating. Everything that Graeme said is entirely correct. But you then hear some of the farmers talking about what they are being paid in New Zealand, and it is almost reminiscent of what was happening in Australia about three or four years ago. There isn't a great affection for the processes, necessarily.

Mr HAMILTON: And the workplace laws in New Zealand are very different from Australia's. They are very much more relaxed. So there's a lot of difference in the labour cost for a New Zealand system compared to the Australian system.

475 The Hon. B.R. HOOD: That's good to know.

476 The CHAIRPERSON: Did anyone else have any further questions for the witnesses? Did you have anything else you wanted to add, gentlemen?

The Hon. J. ELFERINK: I think I have covered more than I expected to when I walked in.

477 The CHAIRPERSON: You have been very generous with your time. I think we have had about an hour together, so thank you both very much for your time today. We appreciate your evidence. You will be sent a copy of the transcript of the evidence you have provided. If there is anything you want to correct, please let the secretariat know.

The Hon. J. ELFERINK: Thank you very much.

Mr HAMILTON: Thank you very much for your time.

THE WITNESSES WITHDREW

