Australian Dairy Industry Council Inc.

23 August 2011

The Committee Secretary,
Senate Committee on the Scrutiny of New Taxes
PO Box 6100
Parliament House
CANBERRA ACT 2600

Re: ADIC submission to Senate Inquiry into the Carbon Pricing Mechanism

On behalf of the Australian dairy industry the Australian Dairy Industry Council (ADIC) welcomes this opportunity to provide additional input to the Senate's inquiry into the carbon pricing mechanism.

The ADIC is the national peak policy body for the Australian dairy industry and represents all sectors of industry on issues of national and international importance. Our member organisations – the Australian Dairy Farmers Limited and the Australian Dairy Products Federation - represent the interests of dairy farmers, manufacturers, processors and traders across Australia. The ADIC's role is to bring together these members to establish a unified dairy position on issues that affect the industry's future across the entire value chain.

This document follows on from our submission to the Committee of 3 May. In May we noted that climate change poses an important challenge to Australia and Australian agriculture. As an industry, dairy broadly supports a comprehensive government and industry response to climate change. In the case of greenhouse gases we recognise the government's' intention to reduce man made emissions by placing a price on carbon via a tax and ultimately an emissions trading scheme. We also recognise the difficulty of developing a comprehensive carbon price mechanism that contributes effectively to lower national emissions without unduly damaging the national and regional economies of Australia.

In May we raised specific concerns about the potential price impacts of a carbon tax on dairy farmers. These concerns remain now that the details of the proposed *Clean Energy Future Plan* are public. While direct on-farm emissions will not be covered under the new scheme, dairy farm businesses still face unacceptably higher costs under a carbon tax. Moreover, the released plan contains several elements that raise significant equity concerns with regard to how dairy will be treated relative to other sectors.

This submission sets out these concerns in more detail and offers some relatively simple remedies.

We look forward to the opportunity to discuss these with the Committee.

Yours sincerely

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Australian Dairy Industry Council Inc.

Australian Dairy Industry Council
second submission to the

Senate Select Committee on New Taxes
Inquiry into Carbon Tax Pricing Mechanisms

Likely impacts of announced carbon pricing arrangements on dairy
As a livestock-based, market oriented industry that involves a high level of processing and value-adding across regional Australia, the dairy industry faces some unique challenges from the taxing of carbon. This risk will be greater if the selected price mechanism operates in advance of, or differently to, those employed by major international competitors.

In May 2011, based on available information, the ADIC estimated that a carbon tax rate set between $20 and $30 per tonne could add between $5,000 and $10,000 per year to dairy farm business costs, even with direct on-farm emissions remaining outside the new scheme.

After reviewing the key elements of the announced *Clean Energy Future Plan* these cost estimates remain valid. They have been affirmed by independent assessments of the likely impact of the new carbon tax on farm businesses, undertaken by the Australian Farm Institute (AFI)[1].

Importantly dairy farming appears to be more impacted by the new tax arrangements than even other parts of agriculture. The AFI estimated dairy farm incomes could fall by 7 - 8% in 2013 under the announced tax package (an impact almost double that facing other agricultural sectors).

The Government's own modelling results imply that dairy as an industry will, initially, be more affected by the introduction of a carbon price mechanism than other sectors. The Treasury's modelling in Table 5.6 of *Strong Growth Low Pollution - Modelling a Carbon Price* project that the Dairy Cattle industry will experience the lowest rate of growth in gross output of any agricultural sector in the decade to 2020 under the new carbon tax. Dairy gross output is forecast to grow by only 1 % from 2010 to 2020 compared to an average growth rate for agriculture of 12% (and growth for other livestock sectors of 10 - 14%)[2]. While dairy processing is not recorded separately in this publication, data presented in Tables 5.6 and 5.10 for the Other Food sector and non-EITE Manufacturing (i.e. the categories that will include dairy processing) show that growth in these industries will lag sector averages over the next decade under a carbon tax.

Given the strong demand outlook for dairy, unless the government has clear (non-carbon related) rationales for this assessment the only logical conclusion is that the dairy industry faces additional costs under a carbon tax regime relative to other parts of agriculture and the economy.

Specific aspects of the Clean Energy Future Plan
Other than the upfront cost issues, the released plan contains several elements that raise significant equity concerns regarding how dairy will be treated relative to other sectors. These include:

- Differing treatments of on-farm energy by source (electricity versus fuel), and
- Planned future increases in off-farm milk collection costs

These aspects of the legislation are adding to the uncertainty facing our industry over future costs. Therefore change is required to the current package to prevent the arbitrary and unnecessary reduction in dairy production across regional Australia.

Farm Energy Costs
While dairy welcomes and supports the Government's decision to exempt on-farm fuel usage from the new carbon tax we believe this measure only partially addresses the issue of on-farm energy usage.

[1] Farm Institute Insights August 2011.
[2] Dairy also has the lowest expected growth forecast within agriculture in Treasury's longer term 200-2050 projections in Table 57

The proposed tax arrangements actually create an anomaly in the treatment of different energy sources on farm to the detriment of Australian dairy farmers.

In the case of dairy, electricity represents a much higher share of farm input costs than it does for other sectors. ABARES has identified that, in dairy, the share of total farm operating costs accounted for by electricity purchases is around three times the level of that occurring in other sectors of broadacre agriculture. By contrast, on-farm fuel use represents a much smaller share of dairy farm costs (about half the level observed in other broad acre agriculture)[3].

While on-farm fuel costs should not change with the new tax, the Government estimates that electricity prices will rise by around 10% or $20 per MwH.

Based on ABARES estimates this suggests dairy farmers face an average per farm cost increase of $1,400 per annum across Australia when the new carbon tax comes into force. Farms involved in irrigated dairying operations are likely to face the highest cost increase. In some regions this cost increase could be much higher. ABARES estimates Tasmanian dairy farms have average electricity expenditure in 2011 of $37,000, suggesting increases for farms in this state of close to $4,000 per year under the new tax.

This indicates that simply because of differences in energy sourcing profiles, dairy farms will face significantly above average increases in energy costs under the new tax. Their electricity bills will rise considerably more than other farms while dairy farms will receive less benefit from the decision to exempt on farm fuel usage from the new tax[4].

Dairy supports the logic of excluding on-farm fuel usage from the new tax.

However, we believe the same logic must be applied to exempt on-farm electricity usage from the new tax. Failure to do so will significantly disadvantage dairy operators who will face considerably higher costs for key inputs under the new tax than other sectors of agriculture.

The fact that dairy farming has been recognised as an *Emissions Intensive - Trade Exposed* sector from the original Garnaut reports suggests such transitional support is warranted. From a revenue perspective exempting on-farm electricity usage from the carbon tax should have only minor implications for the overall *Clean Energy Future plan*.

Linked with this, ADIC will also seek to discuss with relevant government departments whether some of the announced transitional support programs for land users can incorporate initiatives to support and/or fund on-farm energy audits and efficiency programs as a way of minimising unnecessary impacts on farm margins and accelerating overall emissions reductions (a win-win outcome for both industry and the broader community).

Long distance transport

The decision by the Government that fuel usage associated with long distance heavy transport will only be exempted from the carbon tax arrangements for two years is a concern for dairy.

The nature of dairy production means all milk is essentially collected from farms using heavy road transport and transferred to factories for processing. Further, due to the regional nature of dairy production there is also considerable heavy transport associated with the transfer of bulk milk, concentrates and specialised dairy products between factories and ports.

Dairy has extremely limited options to long distance road freight (rail freight is not a practical alternative for on-farm collection). If the current proposal is implemented dairy farms will be exposed to considerable extra costs as processing firms will logically have to recover increased operating costs through higher milk collection charges, leading to a lower net milk price and profits.

[3] Electricity represents around 3% of total on farm dairy costs, whereas the average for other broad acre sectors is 0.8% (ABARE June 2009)

[4] The Australian Farm Institute has separately noted that the exclusion of on farm fuel from the carbon tax has less of a beneficial impact in the case of dairy than it does for other broad acre farms

With farm milk collection charges averaging 2.5 - 3 cents per litre, farm milk collection costs total about $30,000 per annum. So a freight price increase could add an **additional** $500 per year to dairy farm costs from 2014 (an amount equal to the expected upfront cost of the tax for average households).

Given the nature and location of dairy production (and the limited scope for adjustment in this area) the ADIC strongly supports an extension of the fuel exemption for heavy transport well beyond the current planned end date of July 2014.

Dairy processing support

On numerous occasions ADIC has pointed out that the trade exposed status of Australian dairy processing and manufacturing will greatly limit the industry's ability to pass any carbon costs associated with processing onto either local consumers or world markets unless similar arrangements are in place in all our major competitors.

We have also pointed out that while other countries have Emissions Trading Schemes, there is no likelihood of a level playing field now or in the foreseeable future. With dried milk products (those most affected by a carbon tax) some of Australia's major international competitors will not face a carbon pricing mechanism in the next decade. The EU has explicit provisions to provide free permits for manufacturers of dried products up to 2020 to prevent carbon leakage. The US, an increasing presence in world milk powder markets is not likely to impose a scheme any time soon, nor are other emerging competitors in Latin America and India.

Given the strong linkage between international dairy prices and domestic food service and non-retail prices there is a minimal opportunity for Australian dairy processors to pass on the costs of carbon taxing to other customers. This indicates that these costs will ultimately be passed back to farmers in the form of lower milk prices (a view also independently held by the Australian Farm Institute).

Dairy does not qualify for transitional support under the current *Emissions Intensive - Trade Exposed* (EITE) rules. The government has acknowledged this issue and recognised the need to provide some transitional support for primary food processors such as dairy. Under the current package this support will be provided through;

- *Clean Technology Food and Foundries Investment program* (which sets aside $150 million to over 6 years to assist food processing companies to invest in emission reducing technologies and practices, and
- *Clean Technology Innovation Program* ($200M over 5 years to support R&D into emissions reductions

The ADIC regards both these packages as positive steps to support effective emissions reduction. We recognise that detailed guidelines of how these schemes will operate are not yet available. So we are very keen to work with the relevant government departments and parliament to ensure that the programs are developed with sound operating principles and guidelines that will ensure they meet their policy and industry objectives.

Some areas that will need early attention in this regard are:

- ***The definition of eligible food processors***. In previous discussions with government, dairy has understood that the specific food processor program would aim to provide transitional support for trade exposed primary food processors that were closely integrated with their farm supply base (i.e. dairy manufacturers, beef abattoirs, sugar mills). From ADIC's perspective, if the definition of eligible food processor is set very broadly (e.g. if it included any firms classed under *ANZSIC Subdivision 21: Food, Beverages and Tobacco manufacturing*) then the number of eligible firms and hence competition for these limited funds will greatly expand. This could seriously undermine the scope of the program to achieve its original objectives. Dairy would urge that definitions under the *Clean Technology Food Investment program* be set more narrowly to support primary food processors.

- **The timing of funding availability.** The limited detail on the program funding indicates that it will become available from mid 2012 and be phased over six years. A concern for the industry is that, while the announced quantum of support ($150 million) appears significant, if this is spread over an extended period it will delay effective emission reduction across food processing and may lead to anomalies in the status and competitive position of individual firms. We would argue there is a strong case to front load the available funding to ensure that we achieve the earliest possibly implementation of a new lower emission technologies in Australian food processing. Such a step would not increase the aggregate cost of the program but would accelerate reform and reduce the risk of an extended period of unnecessary cost pass-back to Australian farm families.

Land Sector Packages

The *Clean Energy Future Plan* incorporates a number of transitional support arrangements relating to the land sector. Dairy supports these initiatives in principle and is willing to work closely with relevant departments and agencies to ensure that they deliver expected outcomes.

However, we urge caution in assessments of the likely rate of progress in achieving emission reductions. With the *Carbon Farming Initiative* (CFI) we understand that there are currently no endorsed methodologies relating to dairy farming practice change, other than the well established Kyoto rules of planting trees.

Therefore there should be no expectation that there will be quick and easy uptake of CFI credits by dairy farms in a way that would offset the likely costs to producers arising from implementation of a carbon tax.

Offsets and practice change support are a necessary part of agricultural transition but they are not a panacea that removes the need to for action to minimise unnecessarily adverse elements of the new tax.

Concluding remarks

The dairy industry recognises that it has a responsibility to contribute to national efforts to reduce greenhouse emissions, and is working continually on strategies and practices to improve both on-farm and post-farm energy efficiency and greenhouse gas emissions.

The current *Clean Energy Future Plan* incorporates anomalies that will adversely affect dairy's profitability and competitiveness, not just internationally but also relative to some other agricultural sectors. We believe change to mitigate these anomalies is essential to ensure that the passage of the *Clean Energy Bill* and associated legislation does not encourage unnecessarily shifts in dairy production to other parts of the world (carbon leakage) or reductions in dairy production within Australia.

There is also a clear need for industry and government to work closely in setting up the detailed guidelines and rules relating to announced transitional support programs in order to maximise the their effectiveness and impact from both and industry and community perspective.

Dairy also sees an ongoing need to clearly link developments in the carbon pricing mechanism with other national policy initiatives such as water entitlements, food security, innovation and regional development. These linkages must be carefully thought through in order to achieve the successful transition to a low carbon future in which Australia remains a well established producer of safe sustainable foods.