Murray Goulburn Co-Operative Co. Limited
ABN 23 004 277 089

140 Dawson Street Brunswick Victoria 3056
PO Box 4307 Melbourne 3001 Australia
Telephone (03) 9389 6400
Facsimile (03) 9387 5741

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The Secretary
Senate Select Committee on Agriculture and Related Industries
<agriculture.sen@aph.gov.au>
Parliament House
Canberra

Dear Sir/Madam

I write to provide the perspective of Murray Goulburn Co-operative (MGC) in regards to Government policy that can support a vibrant and growing agriculture and food processing supply chain in Australia.

We have addressed a range of key issues that we believe are critical in regards to effective Government policy in achieving the aforementioned goal.

1. Farm research, development and extension including management of climate risk
2. Water policy and farm water infrastructure
3. Emissions and energy policy
4. Support for innovation in food processing
5. Trade reform for improved market returns and higher farmgate prices
6. Reduced costs of regulation

Company Overview

MGC was formed in 1950 and has grown to become the largest processor of milk in Australia; the nation's largest exporter of processed food; the world's second largest international trader of dairy products; and the largest containerised exporter from the Port of Melbourne.

With over 2,600 suppliers, 2,500 employees and nine plants located throughout Victoria and Tasmania, MGC processes more than 35% of the nation's milk supply into quality products which are sold on both domestic and export markets.

In 2007/08 MGC exports were about 370,000 tonnes delivering dairy nutrients to about 100 countries through a range of food channels such as ingredients, supermarkets and food services. Through our Devondale brand, MGC is category leader in UHT milk and spreads and has a significant presence in cheese. The domestic food services industry also provides a significant market.

In 2007/08 MGC revenue was $2.6 billion of which about $1.6 billion was paid to dairy farmers.

A conservative multiplier effect (x 2.5 Source: ABARE) would see MGC's impact on the economy estimated at $6.5 billion – most of which occurs in regional Australia.

The co-operative is wholly owned by dairy farmers and its objective is to maximise returns to its farmer suppliers. MGC offers a single payment system that is available to all its members. MGC suppliers are able to grow their volumes without restriction and supply all milk to MGC at the time of year that best suits their production system. The capacity of MGC to use all milk and generate value from dairy markets is critical to the success of a vibrant growing industry.

The size and ownership structure of MGC means that we play a vital role in the success of the Australian dairy industry. The capacity of MGC to extract returns from international and domestic markets establishes the base for farmgate returns for the majority of Australian dairy farmers, including those that do not supply milk to MGC.

The Recent Dairy Market

The run of below-average rainfall seasons has been the primary cause of Australia's national milk production falling from an all time high of approximately 11.2 billion litres in 2002 to 9.2 billion litres in 2007/08.

Until the financial crisis hit, the international dairy market had been in unprecedented positive territory because:

- world dairy stocks were very low
- demand from growing Asian economies remained strong
- dairy production has been tight in major export countries such as Australia and New Zealand
- the European Union had removed all export subsidies on dairy products.
- some resources had been directed towards crops for biofuels.

Consequently traded dairy prices reached all time highs during 2008.

The result was a 2007/08 farmgate price approximately 50% above the highest price ever paid by MGC and a situation where MGC could not meet the demand from its customers.

However during late 2008 the international market for the key dairy products; milk powders, cheese and fats halved from their previous historical highs. This left dairy prices at or below previous trendline levels. The speed of the market downturn forced MGC, the only remaining whole of chain co-operative, to drop the farm gate milk price during a financial year.

This was an unavoidable and extraordinary step that unfortunately left many farmers exposed to higher cost structures. Most other dairy processors subsequently followed MGC in their pricing. Some farmers supplying milk for the fresh liquid markets were under contract and consequently were not exposed to the fall in world prices.

The market collapse was caused by a combination of factors: lower demand, tighter credit from buyers and short buying. This caused a rapid build up in world dairy stocks - although stocks are still below the levels 3 or 4 years ago.

Nevertheless, the longer-term outlook for dairy products is strong and MGC will continue to focus on longer-term development and growth as we seek to meet the world's future demand for food.

Farm research, development and extension including management of climate risk

If future climate risk is in line with that predicted by climate scientists, then food production and food security is surely the highest priority for the future of the world. Consequently MGC believes there is a case for significant increases in Government funding for Australian agricultural research given Australia's vital role in food export markets including dairy products.

A number of factors including rising input costs, drought, water availability and the uncertainty of climate, are placing pressure on current farming systems. It is critical that research efforts are effectively prioritised, mobilised and coordinated to provide maximum value for dairy farm businesses as they tackle these changes.

Responses need to be short and long-term in their nature. This includes fast-moving systems research that rapidly assesses the changing environment and provides farmers with the most up-to-date options for farm management. Such "rapid-fire" research should take into account the seasonal conditions; commodity prices and input costs, irrigation water availability and trading prices; crop and pasture options and any other key variables. The volatility of the current market and climate has meant that "rules of thumb" have been impossible to apply and farmers need a well-informed debate, lead by agricultural researchers and service sectors, about the best options at key junctures in the season.

Long-term research remains critical as it provides the basis for profitability into the future.

For the dairy industry it is critical that the key elements are well prioritised and funded i.e. pastures; feed grains; cow genetics; labour productivity; environmental sustainability (water, emissions and nutrient management) and adaptation of farm systems.

The skills of farm owners, managers and staff are critical in ensuring that new technology can be applied and that dairy farms can be effectively staffed in the years to come.

Water policy

Governments must ensure that irrigated agriculture in Australia grows and prospers through sustainable farm systems.

Water is a critical resource for milk production systems for stock water, dairy wash down and irrigation. However recent droughts, combined with the response to the climate change issues, have created increased uncertainty around security of supply of water to farms.

In the southern Murray-Darling Basins (MDB) MGC has processing sites in Leitchville, Rochester, Cobram and Kiewa producing a wide range of dairy products including cheese, milk powders, fresh milk, infant formula and specialty ingredients.

Following the introduction of a planned new cheese line in 2009, MGC Cobram will be Australia's largest cheese processing plant producing about 80,000 tonnes of cheese each year. Using a regional multiplier of 2.5 times (ABARE) the value of MGC's dairy production in the southern Murray-Darling Basin is about $2.1 billion p.a.

MGC also has a processing site at Maffra in the Macalister Irrigation District. MGC suppliers and the processing plant are the basis of this regional economy utilising irrigation water from Glenmaggie.

All dairy farmers require significant amounts of water for household, stock and dairy washdown and many utilise water from short-flow river irrigation or from groundwater systems.

MGC believes current Government water policy lacks vision in regards to promoting future productivity growth, promoting export growth and meeting Australia's and the world's future food requirements.

MGC believes that the Australian Government has not outlined a clear strategy for productivity improvement in irrigation regions and has not allocated sufficient funding for this purpose. MGC believes that productivity improvement, the adoption of new technology and improvement in water use efficiency (WUE) – should be separated from the procurement of water for environmental flows. Productivity and WUE are about adaptation of regions to the risks of lower water availability. Linking these outcomes to water procurement will reduce the effectiveness of productivity programs.

Other key issues regarding water policy

- Environmental outcomes must be clearly defined and supported by sound science.
- It is critical that all major policy decisions and strategies about the management of water resources are considered on a triple-bottom-line basis.
- MGC believes that current Australian Government water purchasing strategies are not well-informed by an overall plan. MGC believes that water should only be purchased by the Government following comprehensive engagement with stakeholders and an assessment of the triple-bottom-line impacts.
- Security of water entitlements and subsequent confidence to invest is the highest priority for irrigators.

- It is important that the combination of state and Australian Government water programs over the next five to ten years provide for all reasonable future environmental needs. This should be achieved well before 2019, (when Victoria's bulk entitlement provisions are reviewed), which would allow individual irrigators to invest in their properties knowing that their individual water security will not be reduced via the review. (MGC notes that NSW water sharing arrangements are reviewed in 2014).

- MGC believes that security of water for household, stock and domestic use in dairy regions is critical. We believe that strategies are required in each dairy region to ensure ongoing secure supplies of household, stock and domestic use even in the worst drought years. This applies to all dairy regions.

- MGC believes that the Commonwealth purchase program must have a corresponding (but not directly linked) productivity program that injects funds into agriculture to boost productivity particularly via water use efficiency.

- Simply purchasing water from willing sellers fails to address the true cost of removing water from productive use and imposes the majority of the cost on a small number of communities and industries. By supporting productivity growth the Australian Government can leave communities better able to manage climatic variation and this will drive long-term economic benefits via growth of food production.

Emissions and energy policy

The impact of the proposed Carbon Pollution Reduction Scheme (CPRS) on trade-exposed food sectors like dairying, could have irreversible effects on Australian food production as farmers are forced to bear CPRS costs ahead of the rest of the world. If Australian dairy production contracts in the transition years of the CPRS, milk production assets will be lost and this production will move off-shore – most likely to countries with higher emissions than Australia (carbon leakage).

Under the planned CPRS dairy farmers will have immediate cost impacts due to the costs imposed on the processing part of the food supply chain.

MGC with the cooperation of other dairy companies, Dairy Australia and Ernst and Young, have assessed the CPRS value-added method for the activity defined as "milk drying" to see if this activity meets the threshold for 60% free permits (threshold >3000 tCO2e per $M). This is the most energy-intensive group of activities in dairy processing.

Unfortunately this activity falls well short of the 3,000 T threshold. This means MGC will receive no assistance under CPRS even though we are highly trade-exposed.

MGC will not be able to pass on the cost increases due to the CPRS because of the price setting nature of world markets.

Consequently dairy farmers will pay the costs of CPRS via reduced milk income. At $23 and $40 per tonne for CO2e this represents an average cost of about $5,000 and $9,000 respectively per farming family per year.

New Zealand's emissions trading scheme maintains the link between farm and food processing and recognises the connected nature of the supply chain and its trade-exposure. It provides 90% free permits to food processors that opt-in to their scheme and are assessed as a trade-exposed. This will place Australian dairy farmers and processors at a competitive disadvantage to NZ which is the major competitor and lead to carbon-leakage to lower carbon-taxing countries.

Furthermore CPRS does not cover imports. Most dairy products can be freely imported into Australia. Therefore Australian food industries will be disadvantaged in both domestic and international markets. Over 20% of the Australia's domestic cheese sales currently come from imports.

MGC are committed to improved energy-efficiency and have already made many significant changes to our business to improve environmental sustainability. We have pioneered the use of Liquid Natural Gas (LNG) in prime movers and also lead the sector in regards to water recycling.

The transition period where trade-exposed sectors like agriculture/food processing wait for the rest of the world implement comprehensive emissions trading schemes is the area of real risk for Australia. The dairy sector i.e. farming families, will be disadvantaged to the extent of $9,000 per year (as described above) with no benefit to the environment – in fact a potential negative environmental outcome. The flow on effect will be a less-competitive agriculture/food processing sector and fewer jobs.

The dairy industry via the Australian Dairy Industry Council (ADIC) seeks support mechanisms for food processors similar to those in place in New Zealand. That is, trade-exposed food processors receive 90% free permits for a period of time that allows the rest of the world to adopt comprehensive ETS and that allows farmers and companies to develop research, development and ultimately implement lower-emissions technologies.

Support for innovation in food processing

Innovation in dairy processing can improve product value or reduce processing costs and therefore increase the returns to farmers via their cooperative.

MGC believes the area of innovation "close to market" was not as comprehensively covered in the Australian Government's recent Cutler Review.

Given large research expenditure in the world's other key markets i.e. USA, Europe and Asia - MGC believes that the key to successful innovation in Australia is the adaptation of research including further development and testing before ultimate commercialisation.

In our view, the risks and subsequent market failure at this point in the innovation cycle is understated in the Cutler Review and the opportunities to increase successful innovation via Government support are significant.

In MGC's experience we have many technologies made known to us for consideration. However these technologies have usually been developed for other industries and/or in other countries. The owners of the technology are seeking to partner its development in new industries. The risks and costs of making such steps are underestimated. Companies usually find it commercially difficult to justify the costs of further base research, testing in pilot phase, testing in commercial phase and market development that is required to take concepts forward.

One recent example in Australia is MGC's experience implementing Liquid Natural Gas (LNG) in our 160 prime-mover transport fleet. We have worked hard to pioneer this technology in Australia with some Government support, but have nevertheless faced many hurdles in regards to infrastructure, filling and storage technology, engine technology and availability and Government standards. This example highlights the significant barriers to innovation that exist in a technology that most would have considered fully developed. As it stands today we have been limited to conversion of 54 of our trucks to LNG because of technology and infrastructure barriers.

MGC believes that an industry-by-industry approach is needed in Government innovation support programs. This would include the appointment of skilled practitioners within Government who understand their allotted industry and can identify the best partnerships within that industry.

Significant opportunities exist for productivity and sustainability gains through innovation in the dairy industry in areas as wide ranging as farm systems, water efficiency, transport, milk processing, energy efficiency, functional foods, skills development and market development.

Trade Reform

As a trader of dairy goods on the world market, MGC continues to operate in an environment where market access is distorted by trade barriers and tariffs and competitors still have legal access to export subsidies.

Despite these distortions the Australian dairy industry has grown to be highly competitive.

Along with innovation and market development, trade reform is a lever that can assist in increasing returns from the market and therefore increase the farmgate price.

MGC supports continued Australian Government commitment to pursuing multi-lateral trade negotiations via the WTO Round and parallel comprehensive trade arrangements with key markets to build strategic trade partnerships and protect existing commercial positions.

Regulatory Costs

MGC would also like to reinforce the critical importance of the Australia Government maintaining its 40% contribution towards the co-payment of the export certification process. In a letter received March 2009 MGC was formally informed of the increases to certification fees. This will cost MGC an additional $600,000 per annum.

Our advice is that no other country has full cost recovery for export certification. The removal of the Australian Government's contribution will decrease export competitiveness and mean Australian producers receive lower prices for their produce.

The Australian Government contribution is a critical contribution towards the important role that agricultural commodity exports achieve in creating export dollars for the Australian economy.

Yours faithfully

Ian MacAulay
Chairman