



Australian Dairy Industry Council Inc.

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The Secretary
Senate Select Committee on Climate Policy
PO Box 6100
Parliament House
CANBERRA ACT 2600

Australian dairy industry submission into Senate Select Committee inquiry into climate policy

The Australian Dairy Industry Council (ADIC) welcomes the opportunity to comment on the Senate Select Committee inquiry into climate policy.

In previous submissions to the Garnaut review and the Governments Carbon Pollution Reduction Scheme (CPRS) Green Paper, the ADIC advised that the dairy industry did not oppose the introduction of an emissions trading scheme.

However, our support for any scheme would depend on whether implementation of the scheme would detrimentally affect the international competitiveness of Australian dairy food or lead to unnecessary shifts of dairy production to other parts of the world (carbon leakage).

The Australian dairy market is closely linked to world market prices and is therefore highly trade-exposed. The industry's capacity to recover the additional costs incurred under an emissions trading scheme would be very limited in the absence of similar arrangements in other global dairy producing regions.

Therefore, the introduction of emissions trading has important implications for the future level and viability of Australian dairy production. It will increase costs, affect the viability of different manufacturing and farm systems and add to the complexity of doing business.

The ADIC considers that the following areas require significant analysis before effective policy is established to cover the Australian dairy industry – farmers and processors - under an emissions trading scheme.

Emissions measurement

The lack of a cost-effective and reliable system to measure emissions at individual farm level is an important obstacle to agriculture's coverage.

Accurate, low cost measurement is essential before definitive positions can be taken in this debate. Whether coverage is possible or practical in the absence of such tools is unlikely.

There is a clear need for considerably more R&D on emissions measurement that provides options at farm level before decisions on farm-sector coverage and adjustment can be made. Australia's national dairy service body, Dairy Australia, has an integrated program of work in this area on issues including:

- How to establish clear, agreed methodologies for estimating farm level emissions
- Assessing whether
 - new abatement / reduction technologies will support cost-effective farm and factory business system adjustment
 - timelines for implementation of new technologies could meet planned Government emissions targets

Carbon sequestration

It is likely that the capacity to significantly boost soil carbon levels for most dairy farming systems will be limited.

Many dairy Australian farmers are already implementing management practices that boost soil organic carbon (SOC) production, e.g. fertiliser application, improved rotational grazing, improved pasture cultivars, irrigation, and the application of dairy effluent to pasture. Not only does this mean additional sequestration may be difficult; it means that our capacity to meet any 'additionality' test under Kyoto is limited.

Of additional concern regarding soil sequestration is that once soil carbon is traded farmers no longer own that carbon. If they wish to then plough the land, or change management in any way, thereby decreasing soil carbon levels, they will create a liability that they have to pay to the owner of the soil carbon. Practices being adopted by dairy farmers to adapt to increased climate variability such as increased use of annual pastures and cultivation for forage can all reduce SOC, thus exposing dairy farmers to a soil carbon liability.

Policy analysis

The ADIC considers that a combination of technical and policy research is required to develop appropriate policy formats before the commencement of emissions trading. Areas for consideration include;

- Whether alternative or complementary policies are more appropriate in securing longer term emission reductions in agriculture
- How altered industry practices to reduce emissions at farm level between 2008 and 2015 will be reflected in emissions trading obligations
- Interaction and compatibility of emission trading rules with other national policy objectives such as food security, regional development, drought etc.

Integration of dairy industry

The production and sale of dairy foods is the result of a highly integrated value chain that extends from pre-farm through milk collection and manufacture to exports and final consumer channels.

In the dairy industry, the production and sale of milk at farm level depends on the existence of local dairy manufacturing / processing facilities that can convert this milk into finished product and distribute it for final sale. The reverse equally applies. Australian dairy manufacturing requires local dairy farms to supply its core input. This linkage is reinforced by the fact that Australia operates as an open market oriented economy. As a result of this, marketing and production costs incurred further along the value chain (at dairy manufacturing level) ultimately pass back through to the price paid for milk as it leaves the farm.

The fact that dairy farming and manufacturing are two components of the one integrated supply chain is not always well understood.

One reason for this may be that, in national accounting terms, the dairy farm and dairy manufacturing sectors are treated as separate industries. Farming is classed within agriculture while dairy processing is classed as a manufacturing activity. This statistical separation has logic. However, treating dairy as two separate industries can have perverse consequences in domestic policy debates.

For example, under the planned national emissions trading scheme (CPRS) for example:

- Dairy farming is classed as agriculture - so far no final decision has been made on coverage under CPRS.
- Dairy manufacturing is classed as a general industry for CPRS purposes - will be covered from 2010.

The CPRS recognises the close linkage between dairy farming and processing in some places. In relation to the debate on appropriate Points of Obligation for permit surrender the government is considering whether dairy manufacturers should have to account for the farm level emissions embodied in the milk they collect and process.

However, in establishing the EITE status of food processing industries like dairying, the CPRS reverts back to treating farm and manufacturing as separate sectors. This is important as within dairy, the majority of greenhouse emissions occur at farm level while the larger revenue/value adding stream is centred on manufacturing.

The ADIC recommend that there is an incorporation of a provision that identifies food processing activities as EITE based on the status of their major farm input by value in the relevant base years.

If necessary a minimum threshold criteria could be established so that inputs from one farm sector must represent more than a specific share of total input costs in order for a specific processing activity to qualify. This status could then be reviewed using the proposed time cycle set out in the draft CPRS.

New Zealand emissions trading scheme

The New Zealand emissions trading scheme removes the central risk of trade exposed processors having to pass additional costs back to farm suppliers in advance of direct coverage, while ensuring free permits are linked to trade exposure (the key driver of carbon leakage risks). It leaves open any final ruling in relation to point of obligation for level emissions.

New Zealand approach involves two specific elements;

- Classification of food processing within agriculture for Scheme purposes.
- A voluntary opt-in provision for trade exposed food processors that allows them to seek free permits representing up to 90% of the emissions embodied in specific energy purchases (natural gas, steam etc), in a base year.

It must be stressed that, **to be effective, both elements** of the New Zealand option **must be put in place**. Simply excluding dairy manufacturing from coverage in 2010 does not reduce the risk that trade exposed firms will have to pass unnecessary costs to their farm suppliers (as the costs of fuel, gas and steam will rise regardless of coverage).

In essence it is the EITE treatment of food processing as a covered sector that is the key to removing the potential anomalies of CPRS and their associated costs.

The passage of the New Zealand's Climate Change Response (Emissions Trading) Act further highlights that, unless arrangements with similar effect are embodied in the Australian legislation the introduction of emissions trading will create a clear imbalance in the costs and opportunities facing the closely-competing food processing sectors in Australia and New Zealand. This will greatly increase the risk of carbon leakage from Australian food processing in the period 2010-2015 to the disadvantage of Australian businesses and regional communities.

The ADIC would welcome the opportunity to discuss these issues further.

Yours sincerely



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Chairman