Date Introduced: 7 May 1985
House: House of Representatives
Presented by: Hon. John Kerin, M.P., Minister for Primary Industry

Purpose

This Bill, which provides for the imposition of a levy on total milk production, will in combination with three other related Bills - the Dairy Industry Stabilisation Levy Amendment Bill 1985 (Bills Digest 85/60), the Dairy Produce Market Support Bill 1985 (Bills Digest 85/61), and the Dairy Legislation Amendment Bill 1985 (Bills Digest 85/62) - establish new marketing arrangements for the Australian dairy industry.

Background

The outlook for the dairy industry is depressed, due primarily to the combined impact of a deterioration in the international market and overproduction by Australian producers. The first reason has been caused mainly by the policies of two major overseas producers, the European Community and the United States. Their subsidisation of production and exports has led to the emergence of a large surplus of dairy produce and falling prices. For example, the export price of Australian butter has fallen by over 30 per cent in the last two years. In fact, world market prices are at their lowest levels since 1977.[1] The depressed state of the international market is likely to continue in the foreseeable future.

While this problem cannot be solved by Australian governments or the industry, the second cause of the dairy industry's problems is the nature of the existing marketing arrangements at both the Federal and State level, and the way they have been used. Importantly, the dairy industry in Australia is divided into a market milk sector (milk for human consumption) and a manufacturing milk sector (milk as an input into manufactured dairy products). This separation has been based on historical and geographical factors, and heavy regulation of the market milk sector by each State Government. The involvement of the Federal Government in
the dairy industry is therefore limited to the manufacturing milk sector.

The current marketing arrangements for this sector, introduced in 1977, involve the pooling and equalisation of returns on all sales. Under these arrangements, a levy is imposed on the production of certain dairy products known as prescribed products. Currently, butter, certain varieties of cheese, skim milk powder (SMP), casein and whole milk powder (WMP) are leviable products. About 70 per cent of milk used for manufactured milk products, or 50 per cent of all milk produced, is currently used in the manufacture of leviable products. The levies on prescribed products are not collected on production which is exported. Levies collected on production which is sold on the domestic market are distributed (after deduction of certain 'costs') by the Australian Dairy Corporation (ADC) as an equalisation payment (termed a 'stabilisation payment') on all sales of the leviable product, whether on the domestic or the export market.

Equalisation is a mechanism for averaging export returns for each leviable product among manufacturers, and for distributing assistance raised through the levy on domestic sales across all production. It has had the effect of providing producers with an averaged return that is above export parity.

The operation of this system is illustrated in the following example:

The average export market return for butter is say $1245 per tonne. An exporter will receive this return from the export pool whether he sells his product for $2000 per tonne or for $800 per tonne. A "stabilisation" levy of $1170 per tonne is imposed on all domestic sales. Hence, a manufacturer must receive the average export return ($1245 pt) plus the amount of the levy ($1170 pt), a total of $2415 per tonne, for a domestic sale to be as remunerative as an export sale. The last mentioned figure is often referred to as the Domestic Value for Levy Purposes (DVLP).

Funds raised by the stabilisation levy are distributed across all production of the product concerned. As a result, all sales of butter receive an equalised return of about $1800 per tonne regardless of whether the sale has been on the domestic market at $2415 per tonne or on the export market at a figure as low as $800 per tonne.
These marketing arrangements will be abolished, so that producers will be exposed to price signals from the market and will adjust their production accordingly. There are two ways in which the existing market arrangements have distorted price signals. First, the administratively determined DVLP's have received very large increases - for example, the DVLP's for butter and cheese both increased by more than 40 per cent in the two year period to December 1982.[2] But crucially, the DVLP's are not decreased when the market price falls. Second, and more fundamentally, the process of pooling and equalisation means that producers receive the average price on their marginal production. Therefore, individual manufacturers are rewarded for continuing to produce for export even though the return on the exported products may be less than the cost of production of the milk used in their manufacture. Consequently, these arrangements have encouraged production to increase beyond remunerative market opportunities, to the detriment of the industry as a whole since unit returns are reduced. Also, these arrangements provide little incentive for manufacturers to maximise prices on individual sales or to actively seek new, profitable markets, because the benefits of an individual's efforts are not retained by that individual but are appropriated and spread equally across all sales. Further, the pooling and equalisation of returns means that the optimal mix of dairy products is not clear, since the signals provided by consumers in the form of the price they are prepared to pay for different products becomes hidden. Finally, the increase in DLVP's of local dairy products has increased the competitiveness of imports on the Australian market.

In addition to distorting production patterns, the existing marketing arrangement involve significant costs to Australian consumers, who support the dairy industry through paying higher prices for dairy products than they would in a deregulated market. For example, in 1982-83, the domestic price of cheese exceeded the average export price by 50 per cent, while the difference was 39 per cent for butter.[3] These price distortions resulted in a transfer of more than $100m from consumers to producers in 1982-83, which corresponds to an effective rate of assistance to the manufacturing milk sector of 48 per cent. This compares with a rate of 16 per cent for agriculture as a whole, and 26 per cent for manufacturing industry (in 1981-82).[4]

Under the present arrangements, much of the assistance provided by Australian consumers is not retained in the industry. Rather, a considerable proportion of the producer transfers are dissipated via sales on unremunerative export markets. Losses associated with such sales were estimated at around $25m for 1981-82.[5]
Further, these losses accounted for between one-quarter and one-third of the estimated transfers of consumer income during the late 1970s and early 1980s. In effect, Australian consumers are subsidising foreign consumers since the price at which dairy products are sold on export markets is lower than their cost of production.

In summary, the existing marketing arrangements have encouraged surplus production at great cost to Australian consumers. And despite these costly arrangements, the combination of low market prices and rising farm costs has depressed farm incomes. Further, the level of stocks of dairy products has increased to the equivalent of 22 per cent of total milk production.[6] Both the industry and the Government have recognised that maintenance of existing regulations would result in continued surplus production, and therefore low unit returns for manufacturing milk and chronic low farm incomes for many milk producers. In order to overcome this problem, the industry proposed a marketing plan that sought to achieve lower production via the imposition of production quotas, or entitlements. The Government favours a marketing plan that relies on market pressures to achieve industry adjustment, though the industry will continue to receive assistance.

Outline

The present stabilisation and equalisation arrangements will be replaced on 1 July 1985 with a system of support payments on all manufactured dairy products exports - not just those products currently prescribed but also non-prescribed products. These payments will be funded by a permanent levy (the market support levy) on total milk production and a temporary levy (the dairy products levy) on certain dairy products. The market support levy will finance market support payments, which will be used to increase returns on manufactured dairy products exports to a target price, which will be equivalent to 130 per cent of estimated average export returns received for each product in the most recent two years and the current year. Ultimately the domestic price of manufactured dairy products should be equivalent to the target price, since at that level a manufacturer would be indifferent between an export sale and a domestic sale.

While the market support payments will provide a measure of price support, the level of support will be significantly less than is currently the case. Therefore, the temporary dairy products levy will be imposed to finance supplementary market support payments, which will increase the level of assistance provided above the target price for
up to six years. This arrangement is explained in more
detail in Bills Digest 85/60.

The new system can be illustrated by taking the
example above and showing how the proposed new system would
work for 1985-86.

At present, domestic prices are supported by a
system of levies on prescribed products. In the case of
butter, a levy of $1170 is required to support a theoretical
minimum domestic price of $2415 per tonne. The new system
involves a levy on milk and smaller levies on butter,
butteroil and cheese, with the latter levies being
ultimately phased out. For 1985-86 the milk levy would be
about 1.5 cents per litre, and the levy on butter $557 per
tonne on the assumption of an average export price for
1985-86 of $1200 per tonne.

Market support payments would be $421 per tonne to
achieve the 130% market support target and a further $237
per tonne as a result of the distribution of the levies on
butter and cheese. This means that an exporter receiving
$1200 from an export sale would have his return built up to
$1858 per tonne. As the levy on butter is $557 per tonne,
the same exporter would have to have received a return of
$2415 on the domestic market to be as well off. The figure
of $2415 is the current DVLP for butter, and the rates of
supplementary market support and levy for butter have been
calculated so as to produce this result for 1985-86. In
subsequent years, the supplementary market support payment
and the butter, butteroil and cheese levies will be
progressively reduced until they reach zero.

Under current arrangements, an exporter who sold on
the export market at $1400 per tonne would receive the
equalised price of about one thousand eight hundred dollars
per tonne, as would the exporter who sold for $800. Under
the new arrangements, the former will receive $2058 per
tonne ($1400 plus $421 pt plus $237 pt), whereas the latter
will receive $1458 per tonne ($800 plus $421 pt plus $237
pt).

In contrast to the current arrangements, assistance
provided to each type of dairy product under the proposed
arrangements will be approximately uniform, and the levy
used to fund these payments will be raised on a broader
basis than is currently the case. As such, the new
arrangements will be more equitable and less distorting, and
will therefore encourage the development of a dairy industry
that is more efficient and more responsive to changing
market conditions. The new marketing arrangements have a
"sunset" provision set at 30 June 1991, with a major review being held within four years of their commencement.

The marketing arrangements outlined in these four Bills will be augmented by two other measures; continuation of underwriting, albeit on a revised basis, and provision of finance for adjustment assistance. Export returns will be underwritten at 90 per cent of the average of estimated gross unit returns on export sales over the preceding two years and the year being underwritten. This contrasts with the current underwriting of 95 per cent of gross equalised pool returns. The lower rate is designed to compensate for the greater volatility of export returns vis-a-vis equalised pool returns. However, the new formula is expected to provide a similar level of assistance as the present underwriting arrangements. Also, the Federal Government will provide up to $20m, on the basis of matching grants from participating States, for adjustment assistance to the industry. The major cost of this program is expected to derive from subsidisation of interest costs on 'carry-on' loans.

The Government's plan has been criticised on a number of grounds. While the need for industry restructuring is generally recognised, it has been suggested that the plan will lead to an unnecessarily rapid and disruptive process of restructuring. Therefore, it has been suggested that: export pooling should be phased out after two years rather than be abolished immediately; that domestic prices should be maintained at current levels for two years rather than one; that product levies (and therefore support payments) should be reduced in a planned way, rather than according to the proposed formula which would result in sharp falls in assistance if production and market milk prices are maintained at current levels; and that a more flexible mechanism for determining support payments on individual products be introduced.

This Bill provides for the imposition of the market support levy, based on the milk fat content of wholemilk and wholemilk products. The maximum levy rate will be 45 cents per kilogram of milk fat, (or about 2 cents per litre of wholemilk), with the operative rate being established by regulation following a recommendation by the ADC. The levy, which is payable by the dairy producer, is expected to be about 1.5 cents per litre in 1985-86.

Main Provisions

Clause 2 provides that the Bill shall come into operation on 1 July 1985.
Clause 3 establishes that the Dairy Produce Market Support Bill 1985 shall be incorporated, and read as one, with this Bill.

Clause 6 outlines the basis for determining the amount of levy.

Clause 7 establishes that liability for payment of the levy falls upon the producer of relevant dairy produce.

For further information, if required, contact:

17 May 1985

Economics and Commerce Group
LEGISLATIVE RESEARCH SERVICE

References

2. Ibid., p.35.