Murray Dairy

Submission to

The Productivity Commission

"Market mechanisms for recovering water in the Murray Darling Basin"

September 2009

Introduction

Murray Dairy drives innovation in dairy research and extension with regional knowledge and skills. It is an independent organization funded by Dairy Australia levies, together with funds secured from Government and the community. Murray Dairy is responsible for developing policies and strategic direction for research and extension within the region and sets priorities for related project investment and industry development. The Murray Dairy Board of Directors is accountable to an Industry Steering Group made up of stakeholder representatives from across the Murray Dairy region. The geographic area covered by Murray Dairy includes the dairying areas within northern Victoria, north east Victoria and southern NSW.

Australia exports about 50% of its dairy products. The farm gate milk price is strongly linked to the world export market. In such an environment, dairy enterprises in Australia need to have a high level of cost control, achieve high productivity and have the appropriate risk management strategies in place to ensure long-term profitability.

Within the irrigation region of northern Victoria the access to secure and reliable irrigation systems, relatively low land prices and the proximity to large grain and fodder growing areas have enabled the dairy industry to grow and prosper. The industry has the capacity to substitute farm production inputs, particularly imported fodder and grain for pasture based production systems. Historically, however it has been the reliable supply of irrigation water that has been the critical input underpinning the cost competitiveness of the local industry. Retaining and increasing this regional comparative advantage is critical to the industry's and region's future prosperity.

Future access and efficient use of irrigation water will continue to be critical to the northern Victorian dairy industry. Achieving increased productivity from water use will be dependant upon;

- A stable water allocation process and appropriate government policy that encourages the agricultural community to continue to invest in farm level infrastructure and management systems and for dairy companies to further develop processing infrastructure and markets.
- Irrigation distribution infrastructure with the capacity to provide the level of service required to achieve efficient and cost effective farm water use
- Farm level infrastructure and associated skilled water management to achieve optimal plant growth from the available water and on-going evolution of whole farm systems which are highly responsive to a more variable operating environment.
- Water management authorities with a strategic focus directly related to the sustainable competitiveness of the irrigation sector.

Restoring the Balance: Objectives

Restoring the Balance in the Murray-Darling Basin has the single objective:

> *To acquire water entitlements from willing sellers that represent value for money, and use the water allocated to them for the environment. This will improve the health of the Basin's rivers, wetlands and floodplains.*[1]

Restoring the Balance tends to be viewed as an adjustment mechanism for irrigated agriculture whereby water is secured for the environment. However a broader approach than simply purchasing volumes of water is required to ensure sustainable structural adjustment for irrigated agriculture.

Murray Dairy has a number of other concerns with this objective, which it will outline below:

Willing Sellers:

In any market, price is determined as the optimal point of mutual interest between interested buyers and willing sellers.

Price in the water markets has historically been driven primarily by the economic value of the production that it can support. In years of good allocations, dairy has essentially driven the water market fundamentals.

At the present, a combination of the drought and the severe reduction in the international milk price have created unprecedented stress in the dairy industry. This has created the setting where a large number of sellers are forced to enter the market and leave the sector in an attempt to recover some of their prior capital investment in the total farm business.. Arguably the Government is purchasing water from 'distressed sellers' rather than willing sellers.

[1] www.environment.gov.au/water/publications/mdb/restoring-balance.html

Value for Money:

To date the Government has only been prepared to purchase water at market value. Yet for a collection of dairy farmers to consider retiring a channel network, consideration must be given to the sunk costs they will face. Dairy farms involve a great deal of infrastructure and consideration needs to be given to the assets that are de-valued when water leaves a district.

A collection of dairy farms in Wakool in Southern New South Wales, developed a proposal to close down their channel network, but the Government's reluctance to pay above market value to cover the farmers sunk costs was not acknowledged.

Improving the Health of Rivers, Wetlands and Floodplains:

Successive Government policies have, over the past 100 years, substantially modified many of our inland rivers for a range of reasons including flood control, hydro-electricity generation and irrigation. We must remember that returning rivers to a pre-European or 'natural' state is neither possible nor desirable. However, this does not mean that our rivers, wetlands and floodplains cannot be healthy and delivering benefits for the environment, the community and the economy.

However, improving the health of rivers, wetlands and floodplains does not only involve increasing environmental flows via water purchases. The health of rivers, wetlands and flood plains must also consider:

- whether plant and animal species are native and the presence of exotic species is not a significant threat;
- water temperature
- natural ecosystem processes are maintained;
- major natural habitat features are represented and are maintained over time;

- native river bank vegetation is sustainable along the majority of the river's length;
- native fish and other animals can move and migrate up and down the river;
- linkages between river and floodplain and associated wetlands maintain ecological processes;
- associated estuaries and terminal lake systems are productive ecosystems[2]"

The Federal Government must consider plant and animal species, water temperature and vegetation when improving river, wetland and floodplain health rather than just increasing environmental flows. A transparent environmental assessment of the buyback is required.

Defining Environmental Outcomes:

Environmental demands needs to be clearly and well defined in terms of timing, regularity, quantity, duration and sensitivity to 'missing waterings' rather than just a single volumetric requirement. Environmental water demands can be extremely variable between years and between different locations and these issues must be considered in the development of market mechanisms to deliver required environmental outcomes.

The Government must outline how water for the environment will be monitored; this includes how increased flows and river health benefits will be accounted for, including scientific evidence and finally how the environmental benefits are measured and assessed.

Developing the Basin Plan:

Murray Dairy shares the Productivity Commission's concerns that with the Commonwealth

[2] Victorian River Health Strategy, 2002.

"Focussing on entitlements before the Basin Plan is finalized, DEWAH could end up purchasing the wrong amount or distribution of entitlements".

No details have been released on the Sustainable Diversion limits for each catchment within the Murray Darling Basin and yet large water purchases continue.

Impacts on the market

Government's presence in the market is having distortionary effects; these include:

- **Price:** Government is now the dominant player in the permanent market and is able to afford a price above the level currently regarded as commercial value;

  Volume: the Victorian Government has indicated its willingness to facilitate sale of 300GL above the 4% cap over five years. That effectively doubles the volume that is available for trade. A total of 460GL would represent 25% of the total water entitlement across the GMID. That highly distorts the operation of the market for five years;

  Remaining irrigators need greater assurances about the future, dynamics of water markets and their operation. Making value judgments regarding the future capital value of water is extremely difficult and stifling investment.

- **Temporary Trade:** much of the permanent trade of high reliability water shares is coming from entitlement holders who have traditionally made their water available to the temporary water market. Buyback will therefore erode the volume of 'Allocation' available for purchase and place upwards pressure on the market price for allocation.

  The temporary water market has been an essential mechanism to facilitate adjustment and optimise business decisions across irrigation enterprises. In

wetter years that water will have been used by its owner to grow opportunistic crops. By contrast, in drier years much of that water has traditionally been sold to dairy farmers to supplement reduced allocations to maintain permanent pasture. This arrangement benefits both the seller and the buyer:

- The seller has optimized the value of his entitlement based on the differential between the gross margin he is able to generate by using the water himself or accessing the current market price; and
- The buyer has been able to rely on being able to access surplus water in drier years rather than having to invest capital in purchasing additional high reliability water shares.

Greater clarity is required from the Government regarding future market operation.

Untargeted Buyback

Implementation of Buyback as a stand-alone untargeted program by itself has the potential to generate the following outputs and outcomes:

- a Swiss-cheese effect, with a scattering of de-watered properties across the landscape with no linkage to a coherent regional plan for future optimal land-use;
- an increase in the cost of future infrastructure reconfiguration as the remaining properties are located at random across the region;
- undermining of the value of the investment in new infrastructure water when water is purchased directly from the new automated backbone;
- higher unit costs for the remaining water users;
- reduction in productivity where water is taken from highly productive soils ideally suited to irrigation with low impacts, while leaving other less-desirable areas still heavily irrigated;
- eroded community confidence in the process, who see little coherence or commitment to the bigger picture and longer term viability of the region.

Small Block Irrigators Grant:

Most dairy farms do not meet the eligibility criteria for the Small Block Irrigators Exit Grant Package (own 40 hectares of farms land or less). Its usefulness as a water recovery measure may be questioned, given the small quantities of water available per farm (at least 10 megalitres of permanent entitlements), however, its roles as a special adjustment package may be more effective.

Coordinating Infrastructure Upgrades & Buybacks:

A key principle supported by Murray Dairy is greater coordination between buyback programs and irrigation infrastructure reform. It would be careless to improve infrastructure that then becomes underutilised or abandoned as water moves out of the irrigation area.

Improvements to this situation could include professional support for development of proposals and greater use of farmer groups or other entities to coordinate an approach and directly negotiate with the Commonwealth.

4% Water Trade Out limit:

Murray Dairy supports the need for the orderly transition of water use from within geographic areas for environmental or consumptive use. The establishment of the 4% limit has provided a basis for this orderly transition. Any intentions by Government to buy any significant volumes of water from northern Victoria or Southern New South Wales for environmental use needs to be evaluated in terms of community impacts and impacts on industry, including processing facilities and the capacity to service key markets. This analysis would inform any appropriate change to the current trade limitations.

Under the new agreement between the Victorian Government and the Commonwealth it is proposed that some 460GL should be purchased from the GMID through the Buyback program over a five year period. That is equivalent to 25% of the total available entitlement. That is a very large percentage change in a short period of time.

The Victorian Farmers Federation Water Council has suggested that farmers wishing to permanently trade low reliability water shares not be restricted to the 4% trade out limit. Murray Dairy supports the VFF's position on this.