Calculating the SFFP for the Fair Go Dairy® Logo Scheme.

Summary

Following feedback from industry in the first round of submissions to the ACCC in response to the Authorisation application, QDO seeks to amend Rule 12 of the Fair Go Dairy® logo Scheme Rules that relates to the Determination of Sustainable and Fair Farmgate Price (SFFP).

QDP proposes to use a 2-year average price to smooth fluctuations in price as outlined below. To reduce seasonal inflation impacts, 1 year CPI will be used (at launch this would be 2019/20 and the 2020 calendar year). In addition, QDO intends to use costs specified from the QDAS Report: Appendix - Group Dairy Farm Profit Map (listed as Appendix 10.3 in 2019-20 QDAS Report) to determine the SFFP.

Introduction

The currently proposed method for calculating *SFFP [see rule 12. Determination of Sustainable and Fair Farmgate Price (SFFP) in FGD Scheme Rules]* is likely to lead to massive shifts in price year on year as can be demonstrated using the current formula for the SFFP for 2019-2021. This partially reflects actual shifts in cost of production but more reflects the substantial movements in CPI especially during 2020 due to COVID-19.

QDO proposes a change to the current formula used to calculate the SFFP, using a 2 year average price with a similar methodology to what was previously proposed to flatten the year-on-year variations. This is more commercially sensible to processors who typically in Queensland seek to smooth fluctuations in price over 2 years to create stability and certainty for farmers.

This requires a change to the scheme rules. Specifically, the determination of SFFP contained in section 12 of the scheme rules on page 6 and 7. No other changes are necessary.

Calculating the SFFP under existing scheme rules

The QDAS costs for 2018/19 were 71.6c/L. The QDAS costs released in December 2020 were 78.3c/L which is a 6.7c/L increase on the previous year.

Australian CPI decreased by 0.35% in 2019/20. To calculate the SFFP for 2021/22, 71.6 was multiplied by 2 times -0.35% to get 71.1.

After a 1.9% fall in CPI in June quarter 2020, CPI rose by 1.6% in September quarter 2020. December quarter CPI is expected to be released at the end of January 2021 and if it returns to normal could be around 0.4%. This would be a 2% increase from June to December. If we multiply this by 4, as proposed in the existing scheme rules, this becomes 8%. If 8% is added to the QDAS cost of 78.3c/L this results in a SFFP for 2021/22 of around 85c/L.

CPI

It is not realistic or warranted for any processor to pay farmers 85c/L at this time, and it is not in the spirit of the Scheme to pay more than is considered a sustainable and fair farmgate price.

The increases to CPI largely reflect the impact of COVID-19 on CPI rather than an actual increase in costs. The 8% increase referred to above, is due to the unfortunate timing between financial years and the impact of using 6 months of CPI date to estimate 2 years which is also open to seasonal impacts.

Using a full year of CPI data would remove seasonal and short-term impacts that exists with using 6 months of data. Using 1 year of CPI date is proposed to be used which would be 2019/20 financial year and the 2020 calendar year.

While this creates an overlap in CPI data, the benefits of having a full year of CPI data, as described above, outweigh any negatives. An alternative method would be to use calendar year CPI data for 2019 and 2020. This suggests that the inflationary impacts are to the middle of each financial year which is a reasonable assumption since the QDAS data is an average for the financial year.

Change to CoP calculation

An issue was raised in a submission to the ACCC re Fair Go Dairy® that capital items should not be included in SFFP. This is a valid issue and has resulted in QDO looking at the QDAS data set again to ensure that the information included in the SFFP is fair. In addition, QDO has investigated definitions of profit used by ABARES, the Australian authority on farm surveys, in its farm surveys.

The conclusion, based on ABARES methodology, was that capital purchases and principal repayments are not farm expenses and should not be included in the SFFP. In addition, depreciation is an expense and should be included in the SFFP.

As a result, QDO would like to use the Appendix - Group Dairy Farm Profit Map of the QDAS report (listed as Appendix 10.3 in 2019-20 QDAS Report) to determine the CoP for the SFFP. Specifically, within this appendix, the total operating costs plus finance costs (interest) plus land lease costs. This results in a QDAS cost of 70.6c/L for 2018/19 and 74.9c/L for 2019/20.

Proposed scheme rules

QDO proposes to use a 2-year average price to smooth fluctuations in price mentioned above. To reduce seasonal inflation impacts, 1 year CPI will be used which would be 2019/20 and the 2020 calendar year. In addition, use the costs from Appendix 10.3 of the QDAS report as defined above.

Below shows how the price would be calculated for 2021/22, but the price is only an estimate since December quarter CPI is not yet available.

Year 1 price:

= 2018/19 QDAS * (1+2019/20 CPI) *((2020 CPI * 2)+1)

= 70.6 * (1-0.0035) * ((0.0043*2)+1)

= 70.9

Year 2 price:

= 2019/20 QDAS *((2020 CPI * 2)+1)

= 74.9 * ((0.0043*2)+1)

= 75.5

SFFP 2021/22:

= (Year 1 price + year 2 price)/2

= (70.9+75.5)/2

= 73.2c/L

