DAIRY MARKETING CASE STUDY

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The Constitutional division of powers between the Commonwealth Government and State Governments is an important factor influencing national agricultural policy. In general terms, the Commonwealth may legislate only on specified matters with the States retaining general unspecified powers. In the case of inconsistent laws, the Commonwealth prevails. Some matters are beyond the powers of both, even when they are acting together (e.g. Section 92 of the Constitution). The High Court has held that a Commonwealth or State law which stifles freedom of interstate-trade infringe that Section. The financial arrangements between the Commonwealth and the States is also an important factor. The States are unable to impose excise duties (Section 90). The Commonwealth can make specific purpose grants to States (Section 96).

In areas of agricultural responsibility, the Commonwealth is concerned with overseas trading, export inspections and import quarantine, and marketing arrangements. The Commonwealth is involved in the general assistance area in the rural sector through underwriting schemes, export promotion, and a range of input subsidies (e.g. tax concessions, concessional credit). The States are responsible for the remaining areas of rural policy including land use and agricultural production.

It is in agricultural marketing that the Constitution causes considerable complexity in Commonwealth/State relationships. The Commonwealth has the constitutional power over marketing overseas and among the States and Territories, but no power over marketing within a State's boundaries. However, marketing between States is subject to Section 92 - free interstate trade. The interpretation by the High Court of Section 92 has not been clearly resolved, hence the legitimacy of a number of marketing arrangements under complementary Commonwealth/State legislation is still open to question. Another problem for legislative marketing concerns the interpretation of Section 90 preventing the States from levying excise, and hence making it difficult to obtain funding for marketing arrangements directly from producers.

The complex relationship between the Commonwealth and the State's arising from their respective responsibilities under the Constitution led to the formation in 1934 of Australian Agricultural Council (AAC) and its permanent technical committee, the Standing Committee on Agriculture (SCA). The AAC is a non-statutory body, is consultative only and its agreements are not binding. Final decision remain with the governments involved, although collectively they have the power to implement its decisions. Thus in practice, the AAC is the forum for the development of national agricultural policies which are consistent with both the objectives of the governments concerned and developments in domestic and overseas markets.

The AAC consists of the Commonwealth Minister of Primary Industry, and State/Territory Ministers of Agriculture/Primary Industry. In addition, the Minister of Agriculture/ Primary Industry from New Zealand and Papua New Guinea are invited as observers.

The Chairman is the Commonwealth Minister of Primary Industry. The proceedings are held in camera, but a verbatum record of proceedings is printed and issued on a confidential basis to the Ministers and Departments directly represented on AAC/SCA. The resolutions of the Council are released by all members before they are tabled by the Chairman in the Commonwealth Parliament as soon as possible after each meeting. State Ministers may table these resolutions in their Parliaments.

The terms of reference for AAC have essentially remained unchanged since 1934, and cover such things as promoting the development and welfare of agricultural industries, information exchange on production and marketing, improved quality and standards of agricultural products, ensuring balance between production and markets and marketing arrangements, financial assistance to agricultural industries, and other matters submitted by SCA.

SCA, the permanent technical committee, usually meets for 2 to 3 days prior to the AAC meeting which meets on average about twice per year. Special meetings of AAC are held to consider urgent matters as necessary. The SCA consists of the heads of Commonwealth Department of Primary Industry and

State/Territory Departments of Agriculture/Primary Industries with representatives from CSIRO and Commonwealth Departments of Finance, Trade and Resources, and Health. Officials of the Departments of Agriculture/Primary Industry from New Zealand and Papua New Guinea are invited as observers.

SCA is chaired by State members in rotation. A permanent Committee structure exists beneath SCA to advise on the more technical aspects of policy development and to provide coordination between States. Ad hoc working parties are frequently used to advise SCA on urgent policy issues.

The functions of SCA, in addition to advising AAC on matters arising from AAC's terms of reference also include such matters as the initiation and development of research on agricultural problems, and advising on quarantine measures relating to pests and diseases of plants and animals, ensuring the necessary cooperation and coordination in these matters.

Some criticism has been directed at AAC over the years, largely in relation to its slow procedures and lack of decision making. Much of the criticism is based on an incorrect understanding of the constraints placed upon AAC by its very nature. Given the constitutional division of powers between Commonwealth and State governments, the different political persuasions of Ministers, the impact on membership of elections and changes in portfolios and a consequent high rate of Ministerial turnover, and the strong dominant regional attitudes of State Ministers, it is a wonder any agreement is reached at all.

The recent negotiations concerning dairy marketing arrangements provide an interesting case study.

On 23 November 1983, the Industries Assistance Commission (I.A.C.) report No. 333 on "The Dairy Industry" was released and contained the following recommendations:-

1. The present levy/disbursement system for manufactured dairy products be terminated as from 1 July 1984;

2. Pooling of export returns of dairy products which are currently leviable be continued;

3. A uniform export subsidy of 20 percent of the bulk ex-factory price of all dairy products be introduced as from 1 July 1984;

4. Revenue for the subsidy be derived from a levy on all milk received for processing and manufacture as from
1 July 1984;

5. The gross export pool return of each existing leviable product group be underwritten at 85 percent of the average of its gross export pool returns over the preceding three years;

6. The formula for calculating underwritten returns be specified in the relevant legislation;

7. The Dairy Industry Assistance Act 1977 and The Dairy Industry Levy Act 1977 be repealed; and

8. Assistance to the industry be reviewed within a period of three years from the date of the Government's decision on this report.

The Minister for Primary Industry on 13 December 1983 announced that the report would be released to industry prior to a decision being taken by the Commonwealth Government.

Industry and some State Governments immediately strongly criticised the recommendations.

The report was analysed at the Commonwealth level by various departments - D.P.I., Finance, Treasury, Prime Minister and Cabinet, Trade, Industry, Technology and Commerce, Employment and Industrial Relations, Attorney-General's etc.

At the meeting of SCA/AAC in February 1984, the Commonwealth advised that it intended to implement any new arrangements on 1 July 1985. SCA appointed a Working Party to examine and report on the feasibility and outcome of the implementation of the I.A.C. report. The Working Party was chaired by the

Department of Primary Industries (D.P.I.) and included representation from all States, the B.A.E. and the Commonwealth Department of Finance, and was to report to a special SCA meeting on 13 April 1984.

On 16 March 1984 the Australian Dairy Industry Conference expressed support by a majority vote to a "National Dairy Industry Marketing Plan" and forwarded copies to the State and Commonwealth Governments on 23 March 1984.

The A.D.I.C. plan involved an entitlement scheme for milk production under which the payments for over-entitlement milk would be in line with the return from exports of dairy products. The plan also involved a levy on all milk, export subsidies, product stabilisation levies, underwriting, domestic prices being determined by a formula and other issues.

On 11 April 1984, the Commonwealth Department of Primary Industry presented an alternative proposal for new marketing arrangements. These arrangements modified the existing arrangements towards the objectives proposed by the I.A.C., without the domestic price being tied automatically to international prices. The major aspects of these proposals were:-

- creation of a market milk coordinating committee
- repeal of the Commonwealth market milk legislation
- a formula for domestic prices of manufactured products
- individual export subsidies to be financed from a levy on all milk
- export and stabilisation pools abolished

During April 1984, Midland Milk (Shepparton, Victoria) commenced supplying milk to Jewel Food Stores Pty. Ltd. for sale in Sydney and Wollongong.

At the special SCA meeting on 13 April 1984, SCA considered the I.A.C. report, the report of the SCA Working Party on the I.A.C. report, the A.D.I.C. plan, the report of the SCA Working Party and the D.P.I. proposal of 11 April 1984.

The major recommendations of the SCA report to AAC were that Council agree:

(a) to a committee-type approach to investigating the rational sourcing of market milk;

(b) that future dairy marketing arrangements should continue to provide a measure of domestic price support;

(c) that a levy on all milk produced should not be considered unless its size was strictly limited; and

(d) that no entitlement scheme should be considered which would impede market signals or which did not provide for negotiability of entitlements, and that there be an early announcement that in the event of an entitlement scheme being considered, milk production after 31 March 1984 would not count in the calculation of individual entitlements;

(e) to repeal the Commonwealth market milk legislation.

SCA could not reach agreement on a number of issues and asked the Working Party to-provide further details on entitlements and the DPI proposal.

On 4 May 1984, J. Kerin met with the ADIC Executive and telexed State Ministers with SCA resolution. Mr. Kerin supported ADIC involvement in the work of the SCA Working Party.

During May 1984, the NSW Dairy Farmers' Association presented an alternative marketing plan to the ADIC proposal, in close consultation with the Queensland and W.A. dairy industries.

The NSW plan also included a dual levy system for production management, and only proposed to raise an all milk levy when export prices for prescribed products fell below the long term moving average of export prices.

On 18 July 1984, an ADFF meeting failed to reach consensus on all aspects of the ADIC plan. They unanimously supported orderly marketing for liquid milk, a levy on all milk to support exports and an entitlements scheme. Agreement could not be reached on details such as the size of the levy.

During July 1984, SCA considered a further report of the SCA Working Party and a report from the Commonwealth and referred key areas to AAC for

consideration. AAC supported the development of national marketing arrangements that promoted efficiency in the production and distribution of milk and dairy products. The following key resolutions were made:-

1. The Market Milk Committee was established to investigate rational sourcing of market milk.
2. Support was given to a levy on all milk to support exports - no agreement on size of levy.
3. Support for a domestic price formula for manufactured products.
4. Council could not agree on the details of an entitlements scheme.
5. Council could not agree on the need to repeal the unproclaimed market milk legislation.
6. Underwriting should be continued.
7. The Working Party was disbanded.

The Commonwealth Minister met with A.D.I.C. in Melbourne on 8 August 1984 and stated that the Commonwealth would be taking the initiative in developing the marketing plan and placed constraints on any entitlements schemes before it would be acceptable to the Commonwealth.

During September 1984, a modified A.D.I.C. plan was forwarded to the State and Commonwealth Ministers for consideration.

On 27 September 1984, AAC considered the A.D.I.C. plan and noted that industry agreement to the plan would only be maintained if effective measures were taken to avoid significant loss of revenue in the market milk sector. The following is a summary of the resolutions of the meeting:-

1. Any levy/entitlement arrangement should be based on a national entitlement level of 5 300 m litres and the best of 3 years 1981-1982 to 1983-1984.
2. All States except Victoria agreed to a maximum levy of 2 cents/litre. COMPROMISE WAS ALMOST REACHED AT

2 CENTS/LITRE. (Queensland and W.A. Ministers agreed to discuss with industry a shift from 1.4 (A.D.I.C.) to 2 cents/litre).

3. No further discussion of the ADIC plan occurred because of this disagreement.

4. The Market Milk Committee was requested to report in 28 days on whether there was an imminent threat to disruption of the market milk market and whether the Commonwealth market milk legislation should be proclaimed, Dr. J. Radcliffe chaired the Committee for this exercise.

On 12 October 1984, Midland Milk ceased supplying milk to Jewel Food Stores Pty. Ltd. as a result of industrial action by NSW dairy farmers, milk vendors and members of the Transport Worker's Union.

The Market Milk Committee report was forwarded to members of AAC on 24 October 1984. The Committee concluded that as at 24 October 1984, "there does not appear to be an imminent threat to the orderly marketing of market milk, but a potential threat remains."

The Committee also made recommendation on the administrative detail necessary if the Commonwealth proclaims the legislation.

On 12 November 1984 the Market Milk Committee under the chairmanship of Dr. Harvey commenced meetings to report on rational sourcing of market milk.

The final version of the ADIC Plan was distributed to State and Commonwealth Ministers during December 1984. This plan included greater details on entitlements, the reinclusion of underwriting, the retention of the unproclaimed legislation and a review of tariffs.

The Commonwealth Minister announced that he was not proclaiming the market milk legislation and asked the Market Milk Committee to maintain a watching brief on the situation on 17 December 1984.

On 18 December 1984 the BAE distributed a Working Paper titled, "Realising the Gains from Rational Sourcing of Market Milk" for comment. The report highlighted cost savings from moving towards seasonal calving and rational

sourcing and made recommendations to achieve these gains.

The report received a hostile reception from industry.

The Commonwealth Minister for Primary Industry convened the Dairy Industry Summit in Canberra with Ministers, Departmental Staff and Industry Representatives on 20 December, 1984

The ADIC submission was presented and the Commonwealth Minister for Primary Industry emphasised the importance of a national approach to the industry. Mr. Kerin stated that the Australian Industry needed to address ANZCER and that Australian products should compete with New Zealand on an unsubsidised and undumped basis in future. The Commonwealth also proposed a progressive sharing of the market milk premium.

The summit did not develop into an exchange of views between State Ministers and industry.

The Summit was followed by a meeting of Ministers at which most Ministers endorsed the ADIC plan. The Victorian Minister wanted a greater transfer of funds to Victoria, a progressive deregulation of the market milk sector and more State control over the implementation of an entitlements scheme. The Victorians proposed using the unproclaimed legislation as a basis for transferring funds from the market milk sector to the manufacturing milk sector.

During 6-11 February 1985, SCA and AAC considered two reports from the Market Milk Committee and a paper on Future Dairy Marketing Arrangements prepared by the Commonwealth.

The Market Milk Committee reported on the BAE Working Paper and on progress in investigating rational sourcing of market milk.

The Chief Dairy Officers' Committee was requested to investigate milk quality standards and to report on the means to ensure uniformity.

The Commonwealth proposed a six year plan incorporating the following:

- National entitlement plan reducing from 5 300 to 4 600 million litres in three years from 1 July 1986
- Export returns to be supported to 125% of average export returns for three preceding years, with a base
- Maximum milk levy of 2 cents/litre
- Stabilisation levies to be phased out after four years
- Export pooling to cease for WMP
- Underwriting to continue
- Allowances to cease
- Proclaim the market milk legislation and use the proceeds to promote rational sourcing of market milk
- A rural adjustment package of $40 million.

The States could not reach agreement on the Commonwealth package and the States suggested changes the Commonwealth could make if it implemented the IAC package as indicated. The operations of the Market Milk Committee were suspended

During February 1985 blockades of dairy factories commenced in Victoria in protest at State and Federal inaction on the dairy industry. The Victorian Government granted a two cents/litre price rise for market milk and referred a further increase to the Arbitration Commission.

On 28 February 1985, a meeting of Ministers and the Victorian Premier was held in Canberra on the eve of the Victorian election. All States agreed to support the essential elements of the ADIC plan and a 17% increase in DVLP's. The plan also involved a State agreement not to move milk interstate.

The Commonwealth Minister for Primary Industry released details of the Commonwealth plan to State Ministers, industry and the press on 22 March 1985.

The Commonwealth plan is summarised:

1. A levy on all milk at a maximum of 2 cents/litre (1.5 cents/litre in 1985/86).

2. Market support payments from this levy to be paid for prescribed products at 30% of average export returns for the two previous and the current year.
3. Export pooling and allowances to cease
4. Product levies and supplementary market support payments to apply for butter and cheese. A formula is to apply to phase out the levies over a period of 2 to 6 years, the time depending on the rate of industry adjustment occurring.
5. Underwriting export returns at 90% of the average for the preceding two and the current year.
6. Repeal the unproclaimed legislation.
7. Improved ADC financing arrangements.
8. Imports to be investigated.
9. $40m to be provided for rural adjustment.

This plan was endorsed by Federal Cabinet and Caucus.

During April and May 1985, strong protests against the plan were raised by industry and some State Governments.

Industrial action recommenced in Victoria aimed at seeking State Government approval to a $3.50/kg butter fat underwriting. Milk was poured down drains and factories blockaded reducing Melbourne's milk supply.

J. Kerin commenced meetings with farmers in all States to outline details of the new marking plan.

On 29 April 1985 J. Kerin telexes State Ministers with details of rural adjustment measures to apply for the dairy industry. The States are requested to provide further information and a Working Party involving State and Commonwealth Officers is proposed.

During the week commencing 6 May 1985, dairy legislation is intended to be introduced into the Federal Parliament to allow implementation on 1/7/85.

This obviously has been a long and tortuous process of policy development. In retrospect perhaps it would have been better if the Commonwealth Government had clearly specified the parameters within which any Industry Marketing Plan had to be formulated for it to be acceptable. One could argue that this would have been appropriate say in February 1984 before the first A.D.I.C. plan was produced (March 1984). The same old process of ignoring IAC reports and allowing Industry to develop a plan was followed. Industry was led to believe that all it needed to do was to get agreement between the States and the Commonwealth would then endorse it. That's how it has always happened in the past. But the political and economic scene (especially ANZCER) was different and this message has taken a long time to come through (if it has).

Will it be better next time round?

IAC, Report No 333, The Dairy Industry, 23 November 1983

SUMMARY

There have been major changes in the dairy industry since the mid-1970s when it was last reviewed by the Commission. These changes, which have affected both manufacturers and farmers, have resulted in fewer and larger factories and fewer, larger and more specialised dairy farms returning higher farm incomes.

In 1981-82 the 264 dairy factories employed 18 000 persons and had a turnover of $2600 million. Milk to the value of $1000 million was provided to these factories from 25 000 farms and a dairy herd of 1 .8 million cows. The strong downward trend in milk production during the 1970s has been reversed in the last two years.

Currently about 30 per cent of milk produced is market milk and this provides some 50 per cent of returns to dairy farmers. The supply and distribution of this milk is extensively regulated by State government legislation. The effect of this regulation has been to maintain high and stable consumer prices for market milk. The Commission has estimated that in 1981-82 this involved an income transfer from consumers to producers of between $70 and $100 million or 4.5 and 6.5 cents per litre of milk. This estimate is supported by data on the prices paid by farmers for the rights to supply the fluid milk market. The Commission could find no justification for a transfer of this magnitude in terms of ensuring satisfactory hygiene and compositional standards, or in higher costs of producing adequate supplies of market milk. The Commission also questions the need for governments to ensure stable consumer prices all year round.

The effects of this regulation on processors and distributors of market milk was not examined in detail by the Commission. However, some aspects of it, such as setting of margins, act to prevent the operation of market forces.

The effects of regulation of market milk sales on farmers varies between States and within some States by regions. In States where farmers receive an equalised price for all milk supplied, increased production of milk is encouraged by the high prices set for market milk. This milk is ultimately used to produce additional manufactured dairy products for export. In States where quota

entitlements apply, the net returns to farmers have not increased commensurately with the high prices set for market milk because farmers with quotas have been forced to adopt more costly production methods.

There is little intestate trade in market milk, despite the incentives provided by the high prices maintained for market milk by State regulation. The Commission believes a main reason for this is the threat to such trade by levies that could be imposed under unproclaimed Commonwealth legislation. Other factors identified by witnesses included the fear of retaliatory action by producers in other States and a desire by those within the industry not to upset traditional arrangements. However, while there is a significant price differential between market and manufacturing milk the situation with respect to interstate trade in market milk will remain unstable.

About 70 per cent of milk produced is manufactured into a wide range of dairy products. The manufacture of dairy products is concentrated in Victoria and Tasmania. Manufacturers in these States use about three-quarters of all manufacturing milk and provide nearly all exports of manufactured dairy products. The main manufactured dairy products are butter, cheese, skim milk powder, casein, whole milk powder, condensed milk and other milk based beverage mixes.

Australian exports of these products comprise only a small proportion of world traded supplies and have little influence in determining prices. World trade in dairy products is dominated by the European Economic Community, New Zealand and the United States of America. Following a period of substantial increases in support prices in both the European Economic Community and the United States, world stocks are currently very high for the major dairy products and these have a strong bearing on prices in world markets. The BAE indicated that there could be a sustained depression of world dairy prices. The Commission considers that the policies of the EEC and the USA must be recognised as realities of the world market in framing policies for the dairy industry.

The assistance provided manufactured dairy products is mainly in the form of domestic price support mechanisms and import restrictions. These provide for

transfers of income from domestic consumers to manufacturers and farmers. For the leviable product groups of butter, certain varieties of cheese, skim milk powder, casein and whole milk powder, the current equalisation arrangements involve a tax on domestic sales, the proceeds of which are distributed over all production on a product group basis and implicitly subsidise exports.

The administration of the current equalisation arrangements is partly controlled by the Minister for Primary Industry and partly by the Australian Dairy Corporation. The Commission considers that these arrangements rely unduly on administrative discretion. The basis for decision making on export controls and the size of levies is not clear and there is considerable opportunity for pressure to be brought to bear on decision makers and for representation on decision making bodies.

Assistance afforded leviable products is disparate and has risen sharply in recent years as world prices have fallen. Wide disparities exist in the incentives provided the different manufacturing processes and over time. Production of butter and its by-products has been favoured relatively more than the production of whole milk powder. The pooling associated with the current equalisation arrangements discourages domestic sellers of some products more than others and conversely encourages exports of some products more than others.

Non-leviable products, which use about 20 per cent of milk produced, derive assistance from customs duties on competitive imports. In recent years these have provided relatively low levels of assistance.

The major aims of the Commission in framing its recommendations have been:

- to reduce the regulated separation of the dairy industry into two sectors - market milk and manufacturing milk; and
- to improve the mechanism for the delivery of assistance to the manufacturing sector so as to reduce distortions faced by consumers and manufacturers and to simplify administrative procedures with the aim of reducing administrative discretion.

The Commission has also had regard to witnesses' responses to the proposals put forward in its Draft Report.

The characteristics of the Commission's recommendations regarding assistance to and regulation of market milk, milk for manufacturing and manufactured dairy products are as follows:

(i) the existing levy/disbursement mechanism be terminated but the export pooling arrangements be continued;
(ii) an export subsidy equal to 20 per cent of the bulk ex-factory price of dairy products which are exported be introduced;
(iii) price support be offered through the underwriting of export pool returns to 85 percent of the moving average of export pool returns from the pools of the three preceding production periods;
(iv) the funding of the export subsidy be by means of a uniform levy on all milk produced, but the underwriting be a cost to Government;
(v) the unproclaimed Commonwealth legislation relating to interstate trade in market milk be repealed;
(vi) tariff rates applying to goods under reference be maintained at present levels; and
(vii) assistance to the industry be reviewed within three years of the Government's decision on this Report.

The Commission considers these arrangements would be administratively simpler than existing arrangements, and reduce discretion or the possibility for the system to be manipulated. They would support domestic prices above export parity, but with minimal distortion between products. The Commission considers they would place some pressure on market milk prices, reducing the current consumer to producer transfers, but retain some premium over manufacturing milk prices. The arrangements would provide a more neutral assistance environment for manufacturers which would result in efficiency gains to the community and possible higher manufacturing milk prices for farmers. The Commission also considers the arrangements would lead to a more efficient regional location of milk production and more efficient on-farm production methods.

The export subsidy of 20 per cent is designed to initially provide the manufacture of exportable dairy products a level of assistance equal to the average level of assistance provided over the last two years and the current year. Based on forecast milk production for 1983-84 this level of subsidy would require a levy of about 1 cent per litre on all milk produced. The intended level of assistance would, on 1983-84 production and price levels, represent a reduction in assistance of about $45 million to manufactured milk products. The recommendation to place a levy on all milk produced may disadvantage the production of dairy products which are not exported as their costs would be increased, though some of these costs would be passed on to consumers. It is recommended that existing tariff rates be maintained.

The Commission has recommended that underwriting be based on the preceding three pool returns and not incorporate a forecast of the current pool in the moving average. This would reduce discretion in determining underwritten pool values. If the underwritten value was 95 per cent of the moving average, underwriting payments could be made more frequently under the Commission's recommendation. This is because export pool returns alone would be underwritten and they are more variable from year-to-year than are equalised returns which are underwritten at present. A lower percentage of the moving average would therefore supply similar levels of underwriting support ns Is provided under current arrangements. The Commission has **recommended** that the underwritten value be 8rj per cent of the moving average of pool returns. It considers that any role for underwriting in the long term structure of assistance needs to be evaluated in conjunction with a review of the long term level of assistance.

To facilitate the analysis of the effects of its recommendations the Commission developed a model, termed ORANI-MILK, of dairy production and processing. The Commission has also drawn on some simulations conducted by the BAE using a model which describes the factors influencing the supply of milk at the farm level.

The overwhelming impression from the results from simulations with the ORANI-MILK model is that the adjustment pressures associated with the

changes in assistance arrangements to the manufactured milk sector are relatively minor. They involve only small changes at the aggregate level to the output of milk and milk-based products and the labour demands of the industries producing them. Similarly, the Commission's simulations of the removal of restrictions on interstate trade in market milk indicate that liberalisation of the market milk sector will not lead to large scale reductions in dairy farm activities in any States or to large transfers of market milk between States.

On a State basis, the Commission's recommendations favour Victoria and Tasmania at the expense of the other States though the extent of this redistribution is small in the medium term.

The proposed changes do, however, imply significant relative price changes in production and consumption between the various categories of dairy products. This is projected to lead to significant changes in the commodity composition of production and to increased household consumption and exports of these product.