



# **Australian Dairy Industry Council**

## **Submission to the Productivity Commission Review of Bilateral and Regional Trade Agreements**

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## Introduction

The Australian Dairy Industry Council (ADIC) welcomes the opportunity to present this submission to the Productivity Commission's review of bilateral and regional trade agreements.

The ADIC is the national peak policy body for the Australian dairy industry and represents all sectors of industry on issues of national and international importance. Our constituent organisations – the Australian Dairy Farmers Limited and the Australian Dairy Products Federation - represent the interests of dairy farmers, manufacturers, processors and traders across Australia.

The ADIC's role is to bring together these members to establish and present a unified dairy position on issues that affect the industry's future across the entire value chain.

## General Remarks

The Australian dairy industry has long recognised that its long term growth and profitability is linked closely to its status as a world competitive producer that can develop and retain global market positions.

Around half of Australia's annual milk production is sold directly into export markets as manufactured food products and ingredients. At the same time, Australia applies minimal barriers to commercial dairy imports, having had a long-standing free trade agreement in place with New Zealand.

These factors mean that Australian dairy company and farm gate returns are heavily and directly determined by the prices and conditions prevailing in world markets.

While domestic sales are important to Australian dairy, the local market is relatively mature. Future domestic consumption growth is expected to be slow and closely linked to population increases and product innovation.

Despite positive reforms in recent decades, world trade in processed food products remains significantly distorted. Dairy products, on average, face significantly higher tariff barriers than do other sectors and dairy access to many developed country markets remains subject to quantitative and technical barriers. Import duties in excess of 50% are not uncommon in dairy trade. The world market for dairy products on which Australia depends, represents less than 10 per cent of world dairy production.

In this environment, increasing the flexibility of export markets and improving Australia's access options and opportunities is critical to provide our farmers and companies with confidence in the long term viability of export markets and to drive future growth and investment in our industry.

The Australian dairy industry has long believed that a multilateral approach to trade reform is the best way to deliver sustained and permanent improvement in world food markets. Comprehensive multilateral agreements (pursued through the WTO negotiating round process) are the only way to consecutively address all 'three pillars' of agricultural support that currently distort world food trade – restrictions on market access, export subsidies and domestic supports and subsidies. The dairy

industry, therefore, remains strongly committed to working towards the successful conclusion of the current WTO Doha Round.

However, the dairy industry also supports the pursuit of strategic regional and bilateral trade agreements as a parallel pathway to improving Australia's access to, and potential returns from, important markets for dairy products.

The FTAs that Australia has negotiated in recent years have certain weaknesses from the perspective of dairy. But on balance the industry believes that they have delivered positive returns for Australian dairy producers and will continue to do in future years. They are an important element in improving Australia's long term competitiveness and market position.

The slowing impetus for multilateral trade reform via the WTO Doha Round is a factor that must also be considered in any review of regional trade agreements.

Agreement on the timing and even the process for concluding the Doha Round remains elusive. Many countries are actively pursuing and implementing bilateral trade deals that could have significant flow-on effects on Australia's future competitiveness in key export markets.

The Australian dairy industry, therefore, supports current Government efforts to conclude a range of additional, comprehensive bilateral, regional and plurilateral trade agreements. Such agreements will not only assist industry efforts to improve Australia's long-term market access rights but they will also help to protect our relative trading position in key export markets.

Dairy also believes that, for producers to gain full and continuing benefit from new and current trade agreements, it is essential that government maintain sufficient resources to ensure all agreements are effectively implemented and that access is not undermined by new technical barriers to trade.

## **Specific Responses to Terms of Reference**

### **1. The contribution of bilateral and regional trade agreements to reducing trade and investment barriers and safeguarding against the introduction of new barriers.**

The commercial value of any trade agreement depends on the extent to which it meets certain core principles. These principles include:

- An FTA must provide for comprehensive product coverage
- It must generate meaningful upfront improvements in access conditions based on commercially viable trade volumes
- It must avoid creating new (or reinforcing existing) technical barriers to trade (e.g. inappropriate safeguard triggers, poor quota administration)
- It must provide Australia with access entitlements that are equal or better those afforded major competitors.
- It must ultimately target the removal of all tariff and quantitative access barriers, and
- It must not compromise commitment to the multilateral WTO process

The dairy industry assesses the commercial value of all negotiated trade agreements against these principles. It will continue to do so in relation to all future agreements.

From dairy's perspective, Australia's recently completed FTA agreements meet these principles to varying degrees:

- US (AUSFTA) provides new duty-free access for a range of products, particularly cheese (but often with quota limits). It provides for phased expansions in these quotas but falls short of delivering comprehensive free trade
- Thailand (TAFTA) provides preferential access for key products (although with restrictive transitional special safeguard volume limits) and the phasing out of tariffs on most products (although against extended time lines for some sensitive products)
- Singapore and Chile FTAs provide comprehensive pathways to free trade
- ASEAN provides a mix of tariff preferences and effective limits WTO ceiling bindings at current applied rates. It reinforces Australia's competitive position in a key region although the gains will be shared with a major competitor – NZ).

On balance, these trade agreements are important in terms of protecting and expanding Australia's access to established and growing markets for dairy. In light of the trade deals being put in place by commercial competitors, the negotiation of additional trade agreements with countries and groups such as Japan, China, Korea and the Gulf Cooperation Council are a high priority to build on the platform established in recent trade agreements.

Expanding market opportunities through FTAs can also have positive indirect effects on commercial trade. For example, the creation of new profitable market outlets in countries such as the US can have the effect of firming up Australia's negotiating position with buyers in third country markets. The increased flexibility in Australia's trading options can lead third country buyers to seek to lock in improved long term relationships with Australian suppliers.

Our experience also shows that FTA's are beginning to have a "head turning" effect on trade (i.e. customers in FTA partner markets such as Thailand now look at opportunities for supply from Australia ahead of other suppliers as they see the commercial advantage of setting up long term business relationships linked with FTA preferences.

- The reverse risk is also evident in markets where Australia has not achieved the same FTA outcomes as competitor suppliers (e.g. in China the NZ-China FTA will provide NZ suppliers with a potentially important tariff preference over time, unless Australia achieves a similar trade agreement).

**In all trade agreements, both bilateral and multilateral, the quality of market access provided is as important as the announced volumes.** This is particularly true in those FTAs where transitional quantitative limits are imposed on preferential access. If the administration of new access entitlements is cumbersome, costly or constantly disputed then its commercial value to firms and farmers is significantly diminished.

- The TRQ administration provisions of AUSFTA (which emphasise exporter control) are in line with industry's preferred approach
- By contrast, the arrangements in place in the draft Korea/EU FTA are an example of the type of access conditions that our industry would strongly wish

to avoid. This agreement provides for TRQs to be allocated to importers and administered by local industry bodies that either have no incentive to import or will seek to capture the quota's commercial value.

The signing of bilateral agreements by themselves will not guarantee the end of potential problems arising in Australia's trading partnerships with specific countries. Therefore, it is important, from an industry perspective, that government retains a sufficient capability and resources to successfully address defensive and trade dispute issues as well as strategic trade negotiations.

The role of FTAs in removing technical barriers to trade or in preventing the emergence of new technical barriers to trade remains open.

- Although the FTAs Australia has signed usually include provisions for consultation to remove non-tariff barriers to trade, dairy's experience, to date, has been that these mechanisms rarely accelerate the removal of such barriers.
  - The CER has provisions for harmonization of standards to facilitate trade across the Tasman. Under the ANZCERTA consultative provisions, discussions took place for over 20 years before a relatively simple barrier to the export of soft cheese to New Zealand was finally removed. All that was required in this case was for New Zealand to recognize Australia's food safety laws for soft cheeses such as brie and camembert.
  - The TAFTA bilateral working party has proved similarly ineffective in dealing with commercial problems experienced with Thailand in relation to tariff rate quota administration; food standards and food labelling laws. Nor has the working party been able to achieve more realistic special safeguard mechanisms for cheese. One recent success in removing a technical trade barrier to dairy trade with Thailand (a customs classification of butteroil that cost importers millions of dollars over an 18 month period) was resolved outside of the TAFTA consultative process. As a result, the outcome benefited all exporters to Thailand, not just Australia.
  - Discussions with the US on the removal of technical barriers to utilisation of quota access for cream granted under AUSFTA similarly had to be prosecuted outside the FTA consultation provisions to achieve progress.

Against this, AUSFTA does appear to provide Australian dairy exporters with some ongoing protection against the imposition of new trade barriers.

- US dairy producers have, with variable degrees of commitment, advocated for quota limits to be imposed on imports of milk proteins for much of the past decade. These quotas would be additional to the restrictions already imposed on trade in skim milk powder. The USA is the world's largest importer of milk protein concentrate, casein and caseinates. If the advocated quotas were imposed it would lead to a significant diversion of product into third country markets with an attendant depressing impact on world prices.
- However, industry and government understand that the provisions of AUSFTA will require that Australian exports be excluded from any such action.

## **2. The role of regional trade agreements in lending support to the international trading system and the World Trade Organization**

- The Australian dairy industry has long sought a market-oriented trading system for dairy products that is free of unnecessary government intervention and distortion. Although the Uruguay Round of trade negotiations delivered much needed disciplines, our exporters continue to face high market access barriers and trade distortions. As Australian dairy farmers rely on world market for their livelihoods these continuing trade distortions are unacceptable and must change so that producers can receive returns and plan investments based on underlying commercial dynamics. The dairy industry has therefore insisted that trade reform must deliver:
  - Expanding, commercially viable market access opportunities.
  - A trading environment where product development, production and export decisions are based on market signals and not a response to government policy decisions.
  - Improved market prices and price stability that comes from removal of the corrupting influence of domestic and/or export subsidies.
  - A true level playing field where Australian dairy farmers are not competing against billions of dollars of subsidies but solely on the quality of products and customer commitment.
- As mentioned previously, the main focus of bilateral and regional trade agreements is to improve market access opportunities. It is their inability to effectively address the removal of other subsidies – domestic and export – that has led the dairy industry to support the WTO process of multilateral trade reform as the primary vehicle for improving the flexibility and stability of world markets.
- AUSFTA did include provisions prohibiting the use of export subsidies directly into the Australian market, but the effectiveness of this provision is limited as the major impacts of export subsidies is on sales opportunities in third country markets and on international market prices

One area where the implementation of regional trade agreements can support the broader WTO agenda is through the improved understanding arising from the associated long-term business partnerships. Certainly the implementation of AUSFTA has helped to show that market access reform need not lead to the decimation of the domestic industry counterparts (a claim made regularly by opponents to the agreement beforehand).

- However, in some instance, the recent rush to sign bilateral and regional trade agreements could also be seen to be “white-anting” rather than supporting the multilateral trading system and WTO reform.
  - The plethora of bilateral and regional trade agreements has increased the disparity of tariff preferences in particular markets and increased the complexity of commercial trade in these markets.
  - Attempts by some countries to preserve existing /new trade preferences appear to be complicating the conclusion of a WTO Doha deal.
  - Moves by the EU to use regional and bilateral agreements to extend the current coverage and treatment of Geographical Indications (GIs) for cheese beyond that agreement in the WTO TRIPS agreement also appear to highlight a potential risk in third party FTAs to the WTO system.

### **3. Potential for trade agreements to facilitate adjustment to global economic developments and to promote regional integration**

- The dairy industry recognizes that regional trade agreements have the potential to deliver benefits.
  - Regional trade agreements need to deliver comprehensive agricultural trade liberalization to be of benefit to our industry.
  - Experience to date has shown that the market access benefits may take some time to be fully implemented.
  - Such agreements, if pursued, should be done so in parallel to the pursuit of multilateral agreements. Resources should not be diverted from important strategic or defensive agreements.
- Dairy's experience of the APEC regional process is that it has not played any significant role, to date, in increasing the Australian dairy industry's access and integration into regional markets. The "best endeavours" approach set out in the original Bogor Declaration have not yet resulted in participant countries providing better trade access. However, progress in this area has been overtaken by other more formal negotiating processes such as the ANZ ASEAN FTA negotiations.
- Dairy's experience of ANZ ASEAN is that negotiating a comprehensive agreement proved difficult given the large and diverse group of countries involved. The newly implemented agreement does, however, provide a useful model on how to establish building blocks for long term trade liberalization and economic cooperation within a broader regional economic context.

The new Trans-Pacific Partnership (TPP) negotiations will hopefully provide a further framework to engender increased regional cooperation and integration

- However, there is also the prospect that Australian access rights will be adversely affected by the expansion of customs unions to which we are not a party.
  - For example, the European Union's expansion has meant Australia has had to forfeit market opportunities in countries that have joined the EU. The UK was the first in a long line, with Malta the most recent, where a lucrative market for our hard grating cheeses disappeared overnight only to be replaced by a few extra tonnes of TRQ access in another cheese entirely.
  - We have also seen a similar situation with NAFTA, with US product replacing Australian exports sales in Mexico due to preferential tariff treatment.

### **4. Impact of trade agreements on Australia's trade and economic performance, in particular any impact on trade flows, unilateral reform, behind-the-border barriers, investment returns and productivity growth**

It is difficult to separately distinguish the impacts of trade agreements on industry performance from those of other key market drivers.



- ANZCERTA may be a special case in this context. The introduction of this agreement was a key factor in the rationalisation of commercial and policy arrangements with the Australian dairy industry from the mid 1980s.
- Prior to the introduction of CER two-way dairy trade between Australia and New Zealand was minimal with both countries maintaining barriers to trade. In more recent years exports from Australia to New Zealand have exceeded \$100 million per annum while imports into Australia from NZ regularly exceed \$300 million. There has been significant investment in Australian dairy by the New Zealand dairy company Fonterra over the past decade. Given Fonterra's activities in other countries around the world it is reasonable to speculate that this investment would have occurred even in the absence of the CER Trade Agreement.

For more recent bilateral and regional FTAs it is difficult to separate their impact relative to other factors such as the drought and the global financial crisis. The substantial decline in national milk production since 2003 (down by a cumulative eleven per cent in the five years to 2009) had led to some adjustments in both product and market mix as firms seek the highest return markets and margins in order to maximise the farm-gate prices for local milk.

The following analysis suggests that, for dairy, there has been some competitive advantage in the reduction or removal of tariff barriers through recent FTAs. In most cases there has been minimal impact on the direction of Australian trade.

#### Singapore (2003)

The value of Australian dairy product exports to Singapore increased from \$143 million in 2002 (5% of the total) to \$156 million in 2008 (9% of the total). However, prior to SAFTA there were no tariffs and no significant non-tariff barriers to dairy imports into Singapore. The increase is unlikely to be due to the FTA and more likely reflects a move to increased repackaging and further processing in Singapore for exports to third countries.

#### Thailand (2005)

The value of Australia's dairy exports to Thailand has increased from \$79 million (3% of the total) in 2004 to \$120 million (4% of the total) in 2008. Anecdotal, part of the growth since 2005 reflects Thai importers giving a preference to Australian supplies in preparation for reduced tariff rates. However, New Zealand (our major competitor in Thailand) has secured a similar agreement with Thailand, so the trade gain that can be attributed to this agreement is at the expense of the EU. TAFTA is, however, important in maintaining Australia's competitive position against New Zealand.

#### United States (2005)

The value of Australian dairy exports to the United States has fallen from \$145 million (6% of total exports) to \$103 million (3% of total) in 2008. This reflects a number of factors.

The United States market is price supported and domestic prices generally move independently of world markets. When AUSFTA came into force the US market operated at a premium to world commodity prices.

Since then developments in world trade and production have meant that these premiums have largely disappeared for skim milk powders and cheese. Some price

premiums remain for butter and whole milk powder reflecting the policy weighting of US dairy support towards milk fat (butter).

Expanding US production has also seen it emerge since 2007 as a net exporter of certain dairy products, leading to a closer alignment of US wholesale and world commodity prices.

As a result of these market developments, Australian dairy firms have not fully utilised all available access to the US market in recent years.

Nevertheless, steadily expanding access to the US market remains an important element of Australia's long term export market development strategy for dairy.

#### Chile (2009)

It is too early to demonstrate any impact of the Agreement on trade flows.

#### AANZFTA (2010)

There is no statistical record yet. The main tariff advantages from AANZFTA will be with Vietnam. For other countries, once ratified, the Agreement confirms the relatively low tariff levels that apply (which are well below WTO bindings) with provision for tariff cuts and in most cases tariff elimination over time. As Australia and NZ will both accrue the same advantages, the agreement may result in some preference for Oceania product over product from other dairy suppliers which are not party to the agreement.

### **5. Scope for Australia's trade agreements to reduce trade and investment barriers of trading partners or to promote structural reform and productivity growth in partner countries.**

- The evidence to date would suggest that our recently negotiated FTAs have had a minimal role in reducing trade and investment barriers or promote structural reform within partner countries.
- In the US, domestic debates on the reform of Roosevelt era dairy support programs has, and is running, up against considerable producer conservatism and apprehension regarding change. Australia is too small a player in terms of profile and market access (we collectively supply well under one per cent of total US domestic consumption on a milk equivalent basis) to take a significant profile in this debate.
  - Instead, the Australian dairy industry's trade policy focus post AUSFTA has been on maintaining the quality of existing market access rights; for example preventing imposition of a border tax on the milk equivalent of dairy product imports and opposing tariff rate quotas on imports of milk protein products (milk protein concentrate, casein and caseinates) that would effectively cut trade in half. The United States is easily the world's largest importer of these milk protein products and has been a lucrative, long-term market for Australian origin product for over sixty years.
  - An alternative approach which the Australian dairy industry has persisted with for over a decade via extensive links with US dairy industry stakeholders; industry associations, companies and Government is quiet diplomacy on the benefits of removal of Government price support /regulation of their industry. The AUSFTA negotiating process did allow

for industry-level exchanges on the process of reform in Australia over recent decades and farm and company experiences of this process.

**6. Assess the scope for agreements to evolve over time to deliver further benefits, including through review provisions and built-in agenda**

- To maximise their benefit, all negotiated trade agreements must incorporate both clear binding upfront commitments, and a clear pathway forward that allows commercial participants on both sides to develop long term business partnerships that can evolve and adapt as markets and social expectations change.

It remains too early to judge how well the provisions of recent FTAs will allow trade to develop and evolve over the longer term. The dairy component of AUSFTA, however, provides for the progressive expansion of access within its built-in agenda – including compounding increases in annual quota access volumes of between three and six per cent. Over time this will help offset the initial low volumes of new access granted on some products of strong commercial interest for Australian processors (butter, cheddar etc).

**Concluding Remarks**

Thank you for considering this submission. Given the importance of trade policy and international markets to Australian dairy's future the ADIC stands ready and willing to meet and directly discuss any of the issues raised here with the Commission or, alternatively, to provide further clarifying comments and material. The relevant industry contacts for this are set out below.

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## **Attachment**

### **Australia-U.S. FTA: A Dairy Perspective - Potential Non-tariff Barriers to Trade**

#### Background:

The FTA delivers compounding access to the United States dairy and food ingredient market across a broad range of product groups within the context of quotas and prohibitive out-of-quota tariff rates i.e. a Uruguay Round Agreement on Agriculture framework.

The initial volume of FTA or “exclusive” access and compounding percentage was lowest for the dairy products that form the basis of the current US domestic price support system for dairy- butter, skim milk powder and cheddar. Australia gained potentially valuable access, however, in a number of new product groups such as cream, whole milk powder and European style cheeses.

#### The Reality of Access:

Australian processors partly because of past lack of opportunities in the United States (leading to incomplete knowledge of market conditions and potential customers) and the very slow recovery in milk production since the devastating drought of 2002/03 have not taken full advantage of the quota increases in 2005.

The devil is in the detail in respect of access. As the attached table highlights there are a number of regulatory hurdles to jump, including the provisions of the Bioterrorism Act (registration of business, prior notification of shipments) to exporting.

Of particular concern is complying annually with the provisions of the 1927 legislated Federal Milk Import Act or FIMA to gain Food and Drug Administration (FDA) approval to export cream. This includes meeting plant sanitary and herd health hygiene standards; the latter mandates the absence of Tuberculosis. FIMA actually stipulates that each herd supplying cream to the U.S. must receive a clean bill of health annually. Given the largeness i.e. milk pick-up region and processing capacity of cooperatives in 2006 compared to 1927 this is a “nonsense” requirement.

The actual registration process, involving AQIS and state-based agencies such as Dairy Food Safety Victoria, is administratively burdensome. Secondly the system fails to recognise AQIS standards, leading to un-necessary and costly duplication of food safety measures.

#### Cream Access is Important!

Cream is potentially an important and lucrative export to the U.S. because global (trade) demand is more skewed toward milk protein than milk fat; the US price support scheme for milk fat (as expressed in the form of butter price support) has traditionally operated at a substantial premium to the international commodity trading price. This means premium returns are available. Additionally there are opportunities for value adding through targeted R&D and product innovation.

#### Dairy industry policy position:

Australia seeks to have equivalence recognitions in terms of dairy access to the US via an equivalence agreement or expansion of the 1980 MOU or via an addendum to the FTA or via direct recognition of AQIS's export control standards.

Resolving these access issues may take considerable time and resources (both Dairy Australia and Government) given possible bureaucratic and political resistance in the United States.

**Table on Dairy Product Import Considerations**

Product	FIMA <sup>1</sup>	Grade A <sup>2</sup>	Non-Grade A <sup>3</sup>	Registration of Food <sup>4</sup> Facilities	Prior Notice of Shipments <sup>5</sup>
Cream (incl. half & half, heavy, light & light whipping cream)	X	X		X	X
Manufacturer's Grade cream	X		X	X	X
Acidified and Cultured Products (e.g., Sour Cream, Cottage Cheese, Yogurt Buttermilk)		X		X	X
Milk (including low fat, skim, fortified, and concentrated)	X	X		X	X
Manufacturer's Grade Milk and Milk Products	X		X	X	X
UHT	X	X		X	X
Evaporated Milk		X		X	X
Dried Milk incl. non-fat, non-fat fortified with vitamins; other dehydrated milk products		X		X	X
Ice Cream			X	X	X
Cheese including fresh, processed, and cream cheese			X	X	X

<sup>1</sup> Requires an Federal Import Milk Act (FIMA) Permit

<sup>2</sup> Three options exist to import Grade A: 1) country must be a member of the National Conference on Interstate Milk Shipments, 2) a foreign dairy firm could contract with any current NCIMS member's regulatory rating agency and 3) FDA can evaluate the importing country's system of assuring the safety of dairy products and compare the effect of that system with the U.S. system.

<sup>3</sup> Does not require an import permit or import restrictions. While no approval is necessary to offer non-Grade A products for import into the United States, it is the responsibility of the person who offers the food product to ensure that the article complies with the provisions of the Food, Drug, and Cosmetic (FD&C) Act, the Fair Packaging and Labelling Act (FPLA) and the Nutrition Labelling and Education Act (NLEA), FD&C Acts, and their implementing regulations. In general, these Acts require that the food product be a safe, clean wholesome product and its labelling be honest and informative.

<sup>4</sup> All food facilities must be registered in compliance with the Bioterrorism Act.

<sup>5</sup> Prior notice must be given on all food shipments in compliance with the Bioterrorism Act.