



Australian Dairy Industry Council Inc.

Australian Dairy Industry Council

**Submission to the Australian Government
Review of Export Policies and Programs**

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Part 1: Executive Summary

Dairy Industry Submission to Australian Government Review of Export Policies and Programs

Key Issues

The Australian dairy industry is one of Australia's major rural industries. It operates as an integrated industry across the whole value chain from primary production through manufacturing to retail and export sales.

Australian dairy has long recognised that its long term growth and profitability is closely linked to its position as a world competitive producer that can develop and retain global markets. With around half our annual milk production being sold directly in export markets and no barriers to commercial imports, Australian company and farm gate returns are directly determined by the prices prevailing in world markets.

The dairy market in Australia is well developed and mature. While growth opportunities exist in various product categories, domestic market growth is expected to rise slowly and be closely linked to population increases. Growing export opportunities, therefore, are critical to Australian dairy (and the regions in which it is based).

Unlike Australia, the world dairy market remains characterised by barriers and limits on entry. Only 7 percent of world dairy production is traded in the international market (and much of this trade occurs under bilateral and multilateral quota arrangements). Australian dairy products continue to face many trade barriers and distortions. Unfairly administered tariff rate quotas, very high tariffs and access prohibitions for some dairy products are common examples of these barriers.

For dairy, increasing flexibility in export markets and improving market access options are critical to industry confidence and to drive long term growth and investment in regional Australia.

In view of this, the dairy industry welcomes the chance to participate in this review of current government export policies and programs. This submission outlines a number of issues of importance to our industry's export performance. These include:

- ▶ The global dairy market is entering a period of unprecedented demand growth – driven by population and income growth, changing dietary patterns and new opportunities for dairy components in innovative functional foods and nutraceuticals.
- ▶ For a range of reasons major dairy suppliers have been unable to match this growth in recent times (reflecting combinations of poor seasonal conditions, competition for land, increased input costs and some cases adverse government policy changes)
- ▶ This situation presents a unique set of opportunities and challenges for the Australian dairy industry.

- ▶ However, the favourable trade environment for food does not reduce the importance of fostering new export opportunities for Australia. Food prices tend to be cyclical. The commitment to trade reform of some countries appears to be waning. New challenges, linked to climate variability and energy security, are also emerging that could affect our future export competitiveness.
- ▶ In this environment maintaining a robust export policy framework is essential to provide our industry, and the regional communities that depend on it, with viable options for future growth, collaboration, innovation and adaptation.
- ▶ In recent years the Australian industry has looked to develop high-value markets and channels to expand options for local processors to find the most profitable outlets for available Australian dairy supply. Industry, therefore, is working with Government to develop and implement trade policies that will facilitate this aim.
- ▶ Over the past decade Australian dairy has pursued a multi-pronged strategy to achieve trade policy reform. Recognising the Government's crucial role in securing these reforms the industry has:
 - Supported government initiatives in the WTO Doha Round
 - Supported the negotiation of targeted, comprehensive bilateral and regional free trade agreements
 - Assisted governments in the negotiation of appropriate international rules and regulations regarding the trade of dairy and livestock products (e.g. Codex standards, World Customs Organisation classifications, OIE)
- ▶ At an industry level dairy has also worked directly with counterpart industries to promote the adoption of more open, market oriented trade policies around the world including:
 - Formation and management of the Global Dairy Alliance
 - Active participation in bodies like the International Dairy Federation, International Federation of Agricultural Producers
 - Undertaking direct representation in key dairy producer countries such as the EU, USA, Japan, and China.
- ▶ The dairy industry continues to strongly support efforts to conclude an ambitious, comprehensive multilateral agreement under the WTO. This is important to remove agricultural trade distortions and create a more flexible commercial environment for exporters.
- ▶ At the same time we recognise the need to defend and maintain our market access interests through a parallel path of targeted bilateral and regional trade agreements. The rapid expansion in regional trade negotiations (many of which do not include Australia) poses a real risk to our long term competitiveness in key export markets. To do nothing in this area would see Australian exporters fall backwards and reduce our long term sustainability.
- ▶ There is also a strong need to maintain infrastructures that protect Australian exporters' ability to continue to commercially use hard-won access gains over time. Once secured, access rights must be defended against the arbitrary application of inappropriate technical and regulatory barriers by importing countries. Maintaining the value of access rights must include a capability to operate effectively in:
 - WTO dispute settlement processes,
 - International standard setting forums (Codex, OIE, WCO) and
 - FTA and bilateral review committees

- It also requires a capacity to undertake direct representation on specific trade issues as they emerge in key markets.

Other policies (some of which are subject to concurrent reviews) can also affect Australia's export competitiveness. While they are not the focus of this review it is important that the panel gives consideration to the potential impact of these policies on trade policy outcomes and how complementary they are with Australia's trade policy objectives.

Appropriate regulatory frameworks are important to Australian dairy given our position as a world food industry. But they can affect costs, our relative competitiveness and our ability to innovate and prosper.

In our submission to the Australian Quarantine and Biosecurity review the dairy industry noted that we share the concerns of other rural industries of the need to carefully identify and manage the risks of losses associated with the potential entry of new pests and diseases.

However, these arrangements must still operate in ways that facilitate access to valuable export markets. To balance these competing interests Australia's quarantine system must be based on the principles of science, effectiveness, transparency, timeliness, fairness and harmonisation. Risk assessments should incorporate a broad economic approach to enhance Australian export opportunities. It is also important that the Australian government advocates international acceptance of our national export certification system in order to facilitate the return achieved from trade policy reforms. (A full copy of the Dairy Industry submission is available if desired)

Emerging challenges relating to climate change and energy security have seen the emergence of a number of policy initiatives e.g. greenhouse gas emissions trading schemes (ETS), biofuel policies. The interaction of these new policy initiatives with commercial markets and existing trade policies will be complex and multi-layered. Depending on their structure, these policies could significantly affect the international performance and competitiveness of Australian food industries.

By any standard Australian agriculture and food production is highly trade exposed. In the case of dairy many of our major export competitors are unlikely to be subject to emissions schemes. If Australia adopts an ETS that does not take account of these facts it could greatly affect our international competitiveness and our ability to access specific markets. To prevent this negative effect on the Australian economy it is important that any final ETS provides appropriate compensation for trade exposed agricultural producers and exporters. It will also be important to ensure that any schemes and policies adopted by other countries are fully compliant with existing WTO treaty commitments

Recommendations

Despite the steady push for reform, protectionism remains a significant feature of world food trade. It dampens the ability of industries like Australian dairy to take advantage of the real growth opportunities that exist in world markets. In framing its recommendations to government we ask that the Panel seek continued government commitment to:

- ▶ Give high priority to export focussed trade policies that expand options and market flexibility for Australian exporters
- ▶ Pursue multilateral trade negotiations through the WTO with the aim of achieving a fair and market oriented trading system

- ▶ Pursue parallel comprehensive trade agreements with key countries such as Japan, China and Korea both to build long term business partnerships and defend existing commercial positions.
- ▶ Develop and maintain regulatory infrastructures that facilitate export trade opportunities
- ▶ Ensure trade policy objectives are fully considered in the development of policies on climate change and carbon trading.

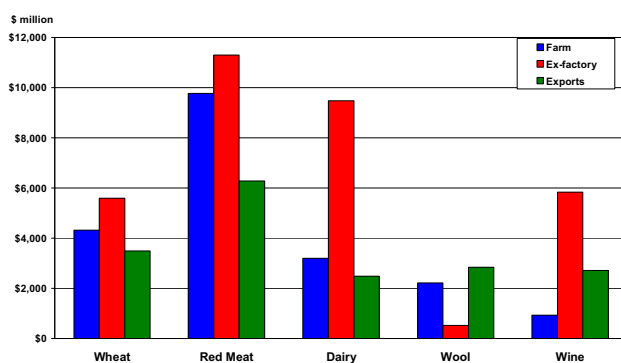
A key principle in the design of trade development programs should also be that they focus on helping existing exporters increase the volume and value of Australian exports rather than simply seeking to expand the number of exporters.

Part 2: The Dairy Industry - A Snapshot

Dairy is one of Australia's major rural industries. Based on a farmgate value of production of \$3.2 billion in 2006/07, it usually ranks third behind the beef and wheat industries. It is estimated that about 40,000 people are directly employed on dairy farms and in manufacturing plants, related transport and distribution activities, and on research and development projects, with a further 60,000 indirectly employed.

Dairy is one of Australia's leading rural industries in terms of adding value through further downstream processing. Much of this processing occurs close to farming areas, thereby generating significant economic activity and employment in country regions. ABARE estimates a regional economic multiplier in the order of 2.5 from the dairy industry

Farmgate vs ex-factory value of production – 2004/05



Dairying is a well-established industry across the temperate and some subtropical areas of Australia. While the bulk of milk production occurs in Victoria (more than 65% in 2006/07), all states have viable dairy industries that supply fresh milk to nearby cities and towns. A wide range of high-quality manufactured products, from fresh products such as yogurts and a wide variety of cheese types to bulk and specialised milk powders are produced in most Australian states. Nevertheless, the manufacturing of longer shelf life products, such as cheese and powders, is becoming concentrated in the south-east corner of the country.

The industry grew strongly through the 1990s, but that growth has not repeated in recent years. The industry experienced a slow recovery from the severe drought of 2002/03, only to be impacted by another drought in 2006/07. Table 1 details the long-term trends in a number of key industry measures.

Australian dairy farmers operate in a deregulated and open market; the only government involvement being in the administration of food standards and food safety assurance systems. Consequently, international prices are the major factor determining the price received by farmers for their milk. Australian dairy farmers receive a comparatively low price by world standards and so must operate highly cost-efficient production systems. The fact that around half of Australia's milk production has been exported in recent years (to more than 100 countries) reflects this high level of competitiveness.

Table 1 Australian dairy industry – long term trends

At June 30	1980	1990	CAGR 1980s	2000	CAGR 1990s	2007(p)	CAGR since 1990
Milk production (m. lts)	5,432	6,262	1.4%	10,847	5.6%	9,582	2.5%
Dairy cows ('000)	1,880	1,654	-1.3%	2,171	2.8%	1,810	0.5%
Farm numbers	21,994	15,396	-3.5%	12,896	-1.8%	8,055	-3.7%
Value of Farm Production*(\$m.)	\$2,937	\$2,737	-0.7%	\$3,467	2.4%	\$3,172	0.9%
Value of ex-Factory Production*(\$m.)	\$7,522	\$6,761	-1.1%	\$10,418	4.4%	\$9,203	1.8%
Estimated value-added* (\$m.)	\$1,832	\$2,020	1.0%	\$2,336	1.5%	\$2,064	0.1%
Per capita consumption (milk equiv)	239	244	0.2%	274	1.2%	295	1.1%
Export Value*(\$m.)	\$887	\$496	-5.7%	\$3,161	20.4%	\$2,532	10.1%
Export Share of Production	22%	31%		56%		52%	

Sources: ABS, ADC, DA, State Authorities

CAGR = Compound Annual Growth Rate

*Expressed in 2006/07 dollars.

Part 3: Response to Specific Questions Raised in Issues paper

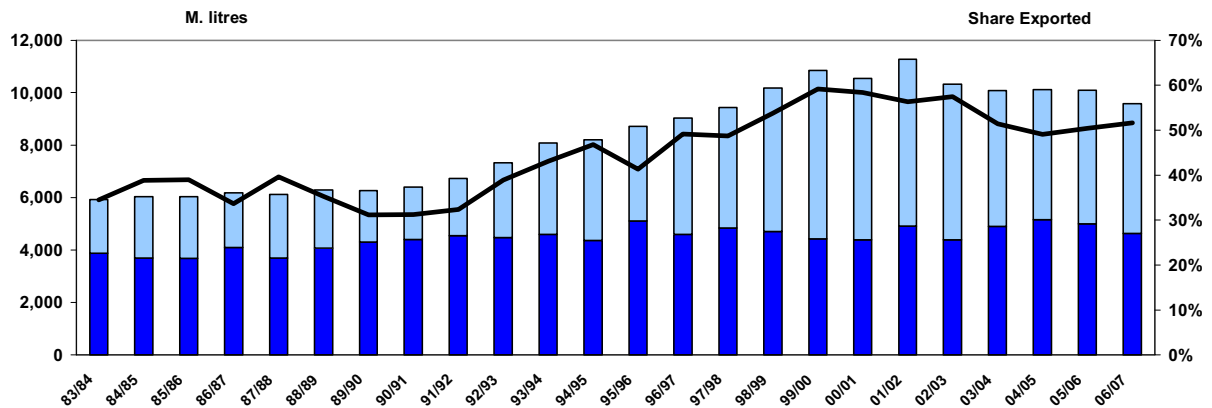
The following responses refer mainly to issues raised in Sections C-1-4 and C7-8 of the Review discussion paper.

Why exports are important to Australian dairy

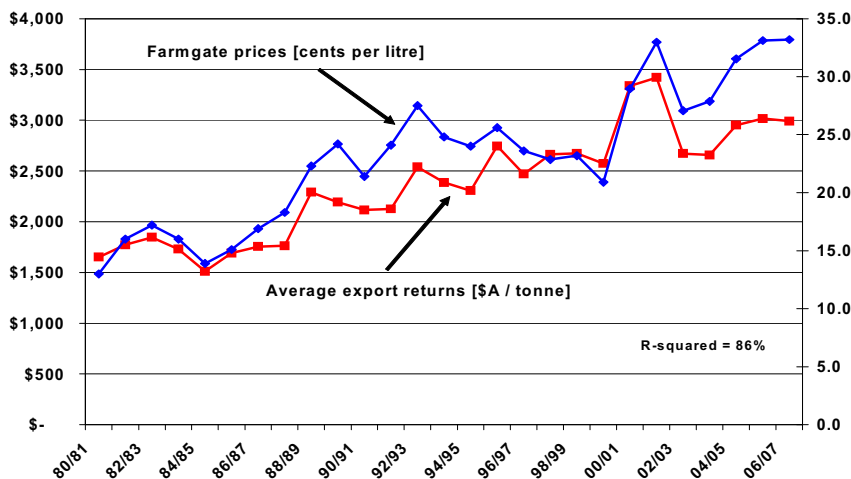
The Australian dairy industry has long recognised that its long term growth and profitability is closely linked to its ability to be world competitive as well as develop and retain global export markets.

The Australian dairy industry operates in a completely open and deregulated market. New Zealand –another major global dairy exporter - has unrestricted access to our market as a result of the Closer Economic Relations agreement of the early 1980's.

For the past decade Australia has regularly exported at least of its annual milk production as finished products and ingredients to over 100 destinations (see figure below)



Because of our open market structure, international prices and market conditions directly influence the prices received domestically for wholesale dairy products. Hence, the international market is the major factor determining the price received by Australian farmers for milk.



Equally importantly, due to the transparency of world market prices, the high proportion of product sold in export markets and the structure and practices of local industry, there is no long term sustainable premium for sales into the domestic market compared to export returns. Over time returns from the two markets tend to equalise.

The dairy trading environment

Australia exports around 800,000 tonnes of manufactured dairy product annually to around 100 destinations with a trade value of around \$3 Billion. While 90 dairy manufacturing firms are regular exporters, a small number of firms account for the overwhelming majority of Australia's export business on both a volume and value basis (the top 12 firms would account for around 90% of export sales).

Our trade performance in recent years reflects the interactions of a range of factors covered in the assessment below.

Domestic demand

The Australia market for dairy products is mature but does continue to deliver volume and value growth. Over 20% of milk production is consumed locally as liquid milk with roughly an additional 25-30% being consumed as products such as cheese, dairyspreads and yogurt.

Large supermarkets account for 55% of domestic dairy sales. Faced with little real growth in same-store sales, larger retailers have implemented strategies to cut supply chain costs, expanding both their private label lines and their convenience store networks.

Private label accounts for a large share of drinking milk sales and the large grocery retailers are likely to take a more aggressive approach here with other dairy products such as cheese and yogurt.

Supermarket chains are feeling the impact of changing consumer lifestyles, which favour easier meal preparation and more out-of-home eating. Foodservice – cafes, restaurants, hotels – sales are growing at a faster rate than supermarket, providing new opportunities.

While export prices for dairy products increased dramatically in 2007 local increases in dairy prices were not as large. This partly reflects the nature and timing of domestic commercial contracts. Domestic prices have subsequently lifted to bring them more in line with world market changes.

Milk supply

Australian milk production sector has been severely affected by drought. This has been felt across all dairying regions. In 2007/08, drought affected almost 90% of Australia dairy farmers. 2007/8 milk production is forecast to be 9.1 Billion litres. This is down 5% on the previous year and 15% lower than the peak production level seen in (pre-drought) 2001/02. The lower production reflects several factors.

National cow numbers have fallen as a result of herd culling during the drought to around 1.7 million cows (down from a peak of 2 Million). The increased cost of key inputs (eg fodder and water) has also affected farm margins, as have higher debt levels associated with drought.

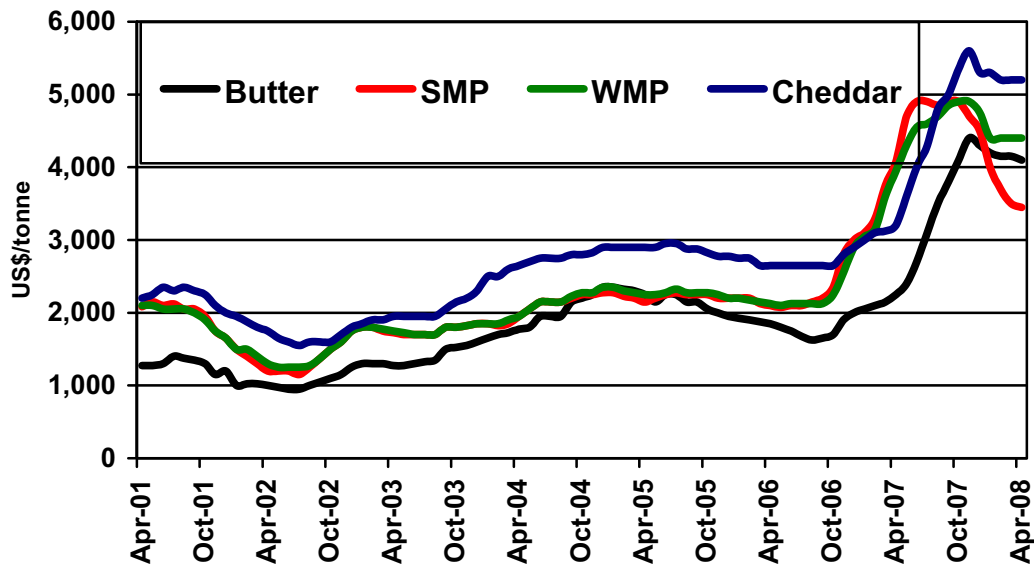
Given the nature of dairying it will take several years to see a significant recovery in the national herd and local milk production. However, higher farm gate prices are rebuilding

farm confidence and should provide a base to support a positive supply response over the next few years.

In this situation a continued strong export market environment is critical to encourage industry confidence to grow and invest.

Global demand

The world market for dairy products entered new territory in 2007, with prices of all major products reaching new record levels. Prices have since eased but remain well above traditional “peaks”.



Even with these historically high prices world demand has proved very resilient. The strong global economy, coupled with increases in population, income and changing dietary preferences has underpinned demand in importing countries. Growing consumption in large milk-producing countries such as Brazil, Russia and China has kept them as net importers of dairy.

As dairy prices rise, ingredient buyers traditionally consider substituting lower priced vegetable-based substitutes. However, strong demand – some of it bio-fuel induced – has raised prices of competing products. In addition, dairy’s functionality has limited the ability and willingness of end-users to further shift ingredient formulations. Instead buyers have absorbed, or passed on, higher dairy input costs in their final prices.

Strong consumer perceptions of the nutrition, convenience and taste benefits of dairy have underpinned demand for dairy in many markets. Oil-related rises in income in many major dairy importer markets have also encouraged continued consumption.

Global Supply

Australia accounts for only 2% of world dairy production (and around 10% of world dairy product trade). Therefore, supply and trade policy outcomes in other major producing countries have a large bearing on world market balance.

Currently global demand growth is not being matched by supply as traditional exporters, besides Australia, have struggled to expand supply.

Production in New Zealand has been flat in recent years due to seasonal factors. Adverse weather (and government restrictions) has limited supply from low cost Latin American suppliers such as Argentine

The European Union (EU) has taken advantage of favourable market conditions to push ahead with reforms to its Common Agricultural Policy. Export subsidies on butter, cheese and milk powders have all been set at zero (which has also helped to sustain world prices).

The EU dairy sector is also benefiting from increased domestic consumption within the expanded EU – now comprising 27 member states. Increased internal cheese demand has seen a significant shift in EU product mix away from butter and powders; which has also meant that government intervention stocks have been reduced to zero.

US production has increased in direct response to strong milk prices. This has seen increased milk powder and cheese exports from this market.

World milk supply is likely to grow around 1 per cent in 2008, and the OECD and FAPRI predict that, while milk supply growth will be steady in the next 5-10 years it will remain behind expected consumption growth

Based on the above there are sound prospects for current higher dairy prices to remain in place for an extended period. However, as world dairy trade will remain thin, trade policy outcomes will still have a significant bearing on the ultimate level and volatility in world prices in coming years. Positive market oriented reform remains essential to reduce the level of volatility going forward.

Future opportunities and challenges

In light of continuing strong demand for dairy both domestically and internationally, there are strong growth opportunities for the dairy industry in coming years, even though it will take time for industry to reach the production levels seen in the early parts of the decade.

Despite the firm market outlook, the dairy industry does face a number of challenges across the whole supply chain.

The production sector

At the farm level, recovery in milk production is likely to be slow and driven more by yield improvements than a quick recovery in cow numbers. Some key farm level challenges are:

- ▶ Rebuilding the national herd size given the fall in cow numbers
- ▶ Addressing increased farm debt
- ▶ Assessing the potential returns from different input combinations (capital, water, pasture, feed, feed stocks and labour)
- ▶ Understanding the likely impact of new technologies on Australia's international cost competitiveness and farm profitability.

The industry will also require investment both from existing farmers and new entrants into Australian dairy farming - either new people (e.g. New Zealanders) or new investment models (e.g. investment funds, private equity etc.) - in order to maximise its growth potential.

Dairy's attractiveness to new investment by continuing farmers and external parties will be linked closely to the expected level of future profits and return on investment. Therefore, world market conditions and opportunities will remain a key driver of these outcomes

Post-farm

Strong world dairy demand and trade is expected to encourage the entry of new suppliers to world markets and ultimately increase competition. These new entrants will prove hard to dislodge for markets if Australian supply remains constrained for an extended period.

Increased worldwide capacity is likely to encourage increased international competition at the commodity level. This will accelerate an existing push by Australian firms to seek additional value from their available milk pool by shifting their product mix towards value added, higher return product lines and new dairy components. The need to secure operational plant efficiencies and margins at times of reduced milk flow will also press manufacturers toward value added products.

There are, however, challenges to industry's push to value added, high return markets. These include more traditional challenges such as technical access barriers (including biosecurity) and competition from non-dairy substitutes. They also include increased regulatory and labelling pressures in relation to the health claims associated with new dairy products.

Consumer/ Retail

The dairy supply chain is facing greater scrutiny from consumers in wealthier markets who are becoming increasingly sensitised to perceived "integrity" issues relating to the environmental performance and production ethics of food producers. They are also expecting higher standards of food safety. The environmental and food safety debates are shifting from individual products and product categories to challenging the entire industry's right to operate.

From a trade policy perspective it will be important to ensure that these debates are not used inappropriately to establish new arbitrary barriers to Australian exports or to diminish our firms' ability to compete in long standing export markets.

Emissions Trading

The planned implementation of an Emissions Trading Scheme presents a particular set of challenges to dairy. The industry recently outlined its position in a submission to the Australian Review of Climate Change (the Garnaut Review). The industry's full submission can be provided on request. From a trade perspective its key elements are:

The dairy industry noted that it understands that Australia has a useful, if modest, role to play in influencing international climate change policy and reform. As an industry, we stand ready to support further analysis and discussion on the policy options open to Australia to meet its international obligations. We are committed to improving our understanding of greenhouse emissions and the viability of different abatement strategies.

However, dairy operates in a very dynamic economic, social and environmental system. Inevitably, when one part of this system is changed other parts will be affected. As a trade exposed industry we see clear risks associated with the development of an ETS if it does not properly reflect Australia's position in the global economy or if it is based on inadequate systems for verifying emission performance.

The impacts of higher energy and fuel costs will be felt by all dairy businesses throughout the value chain. But, as an integrated, export exposed industry dairy faces additional risks. The design of the ETS, therefore, must provide a significant degree of flexibility for sectors such as dairy if it is to minimise unnecessary volatility, uncertainty and dislocation in our key production regions.

Many discussions on an ETS assume that the costs of carbon entitlements can be passed through to final consumers. This may be true for largely non-traded sectors, but the balance is more complicated for price taker trade-exposed sectors like dairy. For an average dairy farm producing 1.1 million litres of milk, the potential annual cost of securing required carbon rights under an ETS could range between \$16,000 (at a low price of \$20 per tonne) up to \$27,000 (at a price of \$38/t which is in line with current EU market pricing).

These figures are significant in terms of dairy farm viability. They represent an extra cost of production of between 3-5% of farm gate revenue. In practice the higher number exceeds ABARE's measured average dairy farm business profit in 3 of the last 4 years (and likely 4 out of 4 in the Murray basin).

Most importantly there is **no** automatic mechanism for farmers to pass the extra cost through to local consumers. We are not in a cost plus world in terms of the price of our key output - milk. When input costs go up farmers cannot automatically raise the price of milk (as shown with recent rises in fertiliser, feed costs etc). So farmers may not be able to recover the cost from consumers. This is particularly true for farmers supplying export firms in South east Australia.

Australia's main competitors in international dairy markets in terms of size are the European Union, New Zealand, USA and Latin American producers such as Brazil, Argentina and Uruguay. For a limited product range (such as milk powder developing countries such as India and the Ukraine are also emerging competitors.

Of these major competitors only one, New Zealand, currently faces the prospect of direct controls and costs on emissions. This reflects New Zealand's unique position in that agriculture accounts for the majority of New Zealand's greenhouse gas emissions under its Kyoto protocol targets. Even New Zealand is considering significant elements of free allocation to farmers in the early part of its scheme

In a competitive market Australian dairy firms' ability to pass on the costs imposed under an Australia ETS to international customers is greatly constrained. This would have direct negative effect on export earnings. Given the strong regional multipliers in place with dairying, the associated social and economic consequences for rural and regional Australia are significant.

Our future ability to compete for, and access, key resources will not be determined solely by the rules of an ETS. The interaction of an ETS with other policy initiatives (such as water arrangements, mandated renewable energy targets) will be equally important to the final outcome.

Considerable additional work is necessary in this area before a realistic assessment can be made of the final impacts of an ETS on rural markets, environmental systems and rural communities.

Dairy is also aware of other countries discussing the option of imposing new trade barriers on exporters who do not meet as yet unspecified environmental performance targets. In the context of this review it is critical that any actions by other countries in relation to emissions trading and environmental practices in general be fully consistent with the provisions of the WTO.

Food Security

In recent times there has been growing discussion about food inflation and its potential threat to food security in developing countries. Australian dairy has long argued that creating open, flexible market systems is a major means of securing long term global food security.

It will be important however to ensure that the food security debate does not become a vehicle for hidden protectionism and act as a means of imposing new arbitrary barriers on access to export markets.

Achievable outcomes and indicators of effectiveness

Australian dairy sees significant growth prospects for exports. This reflects the underlying demand driven by population growth, rising incomes and pressures on available agricultural land around the world. It also reflects dietary shifts based on an improved understanding of dairy's contribution to health and nutrition and the associated demand for dairy ingredients in expanding world markets for functional food and nutraceuticals.

In coming years Australian dairy firms will continue to work to:

- ▶ boost industry margins and profits across the value chain
- ▶ develop and promote higher margin products
- ▶ Create and reinforce high-value markets and channels that provide options for profitably place Australian dairy products

A strong export market is essential to achieve these aims and to encourage renewed growth in local milk production. With the value adding nature of dairy's integrated production system, this growth can generate billions of additional dollars for our producers. Given the strong economic and social multipliers that exist for dairy production in regional Australia, there are substantial additional gains on offer for both the national economy and regional communities across Australia if Australian dairy achieves these outcomes.

A comprehensive suite of export policies covering both strategic reform (e.g WTO), maintenance of access rights and appropriate regulatory environments is crucial to profitable future industry growth. As an industry, dairy will partly judge the success of these policies over time against performance criteria such as:

- ▶ Expansions in Australian access rights to priority markets
- ▶ Reductions in the impact of trade distorting subsidies on world prices,
- ▶ The ongoing commercial viability of established access rights,
- ▶ Australia's access position in key markets versus major dairy competitors and non-dairy substitutes
- ▶ Recognition of Australian certification systems by export partners
- ▶ The extent to which international food standards and systems facilitate rather than impede commercial export sales.

We recognise that the outcomes against measures will shift over time. They will reflect the interactions between both commercial, social and policy drivers. Successful outcomes will also require a close partnership between industry and the government agencies that have responsibility for prosecuting specific policies. Therefore Australian dairy will continue to work closely with Federal and state governments to ensure that Australia is as well placed as possible to take advantage of emerging trends in world food markets.

The Multilateral trading system

The dairy industry has long supported the WTO process of multilateral trade negotiations as the primary vehicle for delivering improved flexibility and stability into world trade.

The Uruguay Round Agreement delivered urgently needed disciplines on agricultural trade, particularly in the areas of trade distorting subsidies.

But, while the Uruguay Round outcomes have been in place for almost a decade, exporters of Australian dairy products continue to face high market access barriers and trade distortions. Unfairly administered tariff rate quotas, high out-of-quota tariff rates and prohibitions on access for some dairy products are only a few examples of the ongoing distortions facing our firms.

Since Australian dairy farmers rely on world markets for their livelihoods these continuing trade distortions are unacceptable and must change so that producers finally get the returns to which they are entitled.

Ever since the commencement of the Doha Round of trade negotiations, the Australian dairy industry has sought a market oriented trading system for dairy products that is free of unnecessary government intervention and distortion. Industry has insisted that a comprehensive round of negotiations 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.

The only way these issues can be addressed in unison is through the WTO/multilateral process. Only the multilateral process can deliver comprehensive reform of export subsidies and trade distorting domestic support as well as new market access opportunities.

Engaging likeminded organisations

The dairy industry continues to endorse a strategy that involves working with likeminded WTO members. It has been a proven strategy that has helped Australia 'punch above its weight'. The challenge is, however, to constantly reassess and understand that goals of coalition partners.

The Cairns Group worked well for many years – up until the Cancun WTO Ministerial meeting. However, due to a number of challenges, the rise of the G-20 developing country coalition has reduced the influence and effectiveness of the Cairns Group. Australia therefore needs to refocus its efforts so that it remains a relevant negotiating partner.

The dairy industry has had success in working in coalitions and alliances. In 2002 export oriented dairy industries formed the Global Dairy Alliance (GDA) with the aim of establishing a fair and market oriented trading system for dairy. Members of the GDA include Argentina, Australia, Brazil, Chile, New Zealand and Uruguay. Together the GDA represents well over half of the world's dairy trade.

Since then the GDA has established itself as the foremost advocate of pro-dairy trade. The GDA has produced many publicly available policy papers as well as briefing documents for member governments.

The Global Dairy Alliance has worked in partnership with the Cairns Group Farm Leaders to raise the profile of agricultural exporting countries.

This is also a good example of industry-government partnership where industry can provide government with detailed analysis to assist with setting negotiating priorities.

New strategies

It is clear from the way the Doha Round of trade negotiations is being conducted that comprehensive trade rounds - negotiated as a 'single undertaking' – have become increasingly cumbersome, costly and time consuming.

Even so the dairy industry strongly urges the government to continue to seek to bring the Doha Round to a successful conclusion.

Following the conclusion of Doha it is appropriate to reconsider what alternative approaches could be examined that would expedite the goals of the WTO without jeopardising Australia's long term export interests. Some options that may warrant consideration are:

Litigation

The question for the dairy industry is often not so much about finding or establishing new markets as implementing disciplines in existing markets and other dairy producers or exporters. If multilateral trade rounds will not deliver these disciplines then a more proactive litigation or dispute settlement route may.

The framework of international trade rules as currently laid out could deliver greater disciplines in relation to domestic subsidies, for example. Industry could support such action but it would require a clear commitment from Government that it is willing to devote the necessary resources to take such action. Industry cannot be expected to carry the burden alone.

Sectoral liberalisation

Another way to achieve market access is through sectoral liberalisation initiatives (also known as 'Zero for zero'). The dairy industry has undertaken some research on this issue and came to the conclusion that sectoral liberalisation initiatives could provide a net benefit to both dairy exporting and importing nations by boosting the rate of growth of demand, expanding international trade, fostering product and market development and integrating the industry on a commercial and transparent basis.

Sectoral liberalisation may not need to be undertaken on a whole suite of products but could be negotiated only on one or two categories (in the dairy industry this could be done on just cheese, for example). For such an initiative to be of benefit, however, it would truly have to be 'zero for zero'; that is, the complete elimination of market access barriers and trade distorting supports.

Reform of the WTO

As an industry dairy would support initiatives that strengthen a rules based multilateral system and address current 'faults' within the WTO rules including a lack of 'stick' for non-

compliance; the length of time and costs required to see disputes resolved; and issues regarding GATT & FTA compliance.

Free trade Agreements

While the dairy industry strongly believes that the best trade gains for our industry are likely to be achieved in the multilateral context, the expansion of FTA negotiations mean that they remain an important parallel influence on our relative competitiveness and returns. This is particularly so where countries are using FTAs to establish preferential deals for dairy imports from third country.

Australian dairy therefore sees both strategic and defensive reasons for pursuing a targeted program of comprehensive FTAs with key trading partners.

The two most significant FTAs negotiated by Australia in recent times, from a dairy perspective have been those with the USA and Thailand.

Both these FTAs have flaws. But they also provide Australian exporters with a position in the market not enjoyed by other exporters and provide scope for building long term partnerships with domestic business partners.

The Australia US FTA provides Australia with growing access to an important dairy market. While the trade in recent years has not met early expectations, this is largely because of the changed world dairy market environment which has seen Australian exporters redirect product to markets which are more profitable in the short term.

The Thai FTA offers the prospects of full liberalisation (albeit after an extended period for some products). However, access to Thailand has been restricted by special safeguards with trigger volumes which are so small as to not be commercially significant. However, importers in Thailand do indicate that the existence of lower tariffs on imports from Australia is a factor in determining preference. So again, while trade volumes have not increased dramatically, the FTA has provided a better environment for developing the market in the future. As the SSG volumes grow and tariffs come down this advantage will become more important.

Moreover, TAFTA also ensured that Australia did not lose its position in the market against other suppliers since a NZ Thailand CEPT Agreement has subsequently come into force.

Other strategic trade agreements that could be very beneficial from a dairy perspective include those currently under negotiation with Japan, China, Korea, the Gulf Cooperation Council, Mexico and Chile.

In all cases dairy believes the negotiated agreements should be comprehensive in nature and accommodate all agricultural food groups.

Some of the above negotiations are also important from a defensive point of view. As an industry we are concerned that New Zealand, the EU or US have, or are working to establish, preferential trade positions for dairy in markets where we have long established presences. Examples include the Korea US FTA and the NZ China FTA once they are ratified and come into force. While Australia works to get agreements with these key dairy partners, the US and NZ can strengthen their competitive position. The risk of these agreements to our industry is that we may never regain lost market preference from our competitors.

Similarly we are losing ground to the EU as they negotiate agreements with southern and northern African countries and with countries in the Middle East, such as Egypt.

It is imperative, therefore, that Australia pursue FTAs with the priority countries listed above. This is, in many respects, more important than pursuing new FTAs in countries such as Indonesia and India where competitors are less likely to emerge with a local advantage as a result of FTA preferred access.

In negotiating FTAs, the WTO position of substantially all trade should be factored in. It is, however, important to note that many of our competitors are more pragmatic. It may be necessary to examine this more closely as we negotiate future FTAs. The NZ-China FTA, in providing commercially meaningful access up front and ultimate free trade in dairy products, is a good model to be followed where the better objective of substantially free trade in all products can not be achieved up front.

Regional Trade Agreements

The dairy industry recognizes that regional trade agreements have the potential to deliver benefits. However, 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.

Any RTA would need to deliver comprehensive agricultural trade liberalization to be of benefit to our industry. Experience to date has shown that FTA's have not been comprehensive in that agricultural liberalization has been either excluded or severely restricted or delayed. With large protectionist economies such as Japan and the United States part of APEC, it is likely that agricultural liberalization would be compromised.

Another reason to be cautious with regard to RTA's is that any such agreements would also benefit competitors such as New Zealand, the US and Canada.

The experience of the ANZ ASEAN FTA negotiations is that it is very difficult to negotiate with such a large and diverse group of countries. It does, however, provide a useful model in establishing building blocs for long term trade liberalization and economic cooperation within a regional economic bloc. The mooted ASEAN plus (two, three, four and six) proposals would appear to be more likely to be achievable.

To date, APEC has not had any significant role in increasing the Australian dairy industry's access to regional markets. The "best endeavours" approach set out in Bogor did not result in any country providing better trade than in the past.

Behind-the-border trade barriers

Trade agreements are essential to establish long-term pathways for increased business partnerships and opportunities.

Equally important is the need to ensure that, once negotiated, these market opportunities can continue to be converted into profitable commercial trade.

In recent years, as traditional trade barriers have been reduced, there has been an increased tendency for import countries to resort to technical regulations and barriers to restrict trade. Dairy has experienced many examples of this in recent years including:

- ▶ US moves to impose quantitative limits on imports of milk protein and caseins
- ▶ Japanese moves to re-allocate medium fat cheeses to tariff categories that would prohibit trade
- ▶ Moves to re-define whey cheese classifications within the WCO
- ▶ Thailand factory registration issues

As an export focused industry dairy is fully aware of the need to work vigorously with government (both in bodies like Codex and WCO and through direct representation) to ensure that trade opportunities are not closed off by inappropriate changes to food regulations or import licensing procedures.

Given that industry has worked hard with government to adopt internationally compliant certification and licensing systems we also support the need to maintain a national capacity to push for international acceptance of Australian systems for export sales.

Food Security

In recent times there has growing discussion about food inflation and its potential threat to food security in developing countries. Australian dairy has long argued that creating open, flexible market systems is a major means of securing long term global food security.

It will be important however to ensure that the food security debate does not become a vehicle for hidden protectionism and act as a means of imposing new arbitrary barriers on access to export markets.

Structural and supply side factors inhibiting Australian export performance

To be able to maintain efficiencies and margins across the value chain, the industry seeks to minimise the impact of factors that add unnecessary cost and burdens to export performance. The industry has identified such inhibiting factors as being:

- ▶ **Infrastructure:** The maintenance of road, rail and port infrastructure is of vital importance. Collection of milk from farms, transport of value added product to market and export of product requires world standard infrastructure. With the industry's export focus, shipping and port capacity is key to bring products to international markets quickly and efficiently. If investment and maintenance of infrastructure is lacking it could lead to loss of profitability through added costs and loss of markets.
- ▶ **Power/electricity:** The industry requires a reliable and growing power supply to facilitate growth across the value chain. However, there is growing concern that capacity will not meet demand, particularly in major dairy producing regions in south eastern Australia.
- ▶ **Production inputs – feed, fuel, fertiliser, finance:** the rise in on-farm input costs will impact farm profitability. The exogenous nature of these cost increases will also add to uncertainty.
- ▶ **Labour:** Farmer surveys have identified recruiting and keeping staff as an ongoing input issue. In 2007, over half of Australian dairy farms had at least one other staff member working in a paid role in the farms business, besides the owners. However, there is increasing competition for people in regional areas due to low unemployment in the overall economy, strong demand for labour in mining and the departure of people from drought-affected communities. As a result, hiring labour has become problematic for dairy producers.

Innovation

Investments in research and development, extension and commercialisation are integral to the success of the Australian dairy industry. Investment has enabled the dairy industry to be at the forefront of change, to build sustainable competitive advantage and to deliver significant public good in areas such as sustainable natural resource use, environmental outcomes and improved food safety. The Australian dairy industry believes a partnership with government is critical to amplify the industry and public good outcomes of a strong innovation system.

The Australian dairy industry is a leader in the agri-food space, creating new and effective ways to successfully innovate across the whole value chain – farm, manufacturing, new products and market creation (domestic and international). Since the early 1990s, the industry has rapidly evolved its innovation processes and pathways and has built its understanding and capacity to manage innovation on farms, within companies, and in a range of collaborative ventures. At the present time the industry is a market leader in its application of open innovation systems that operate globally, are multi-disciplinary and, most importantly, are commercially led.

Innovation is non-linear and consists of cyclic systems operating in their own right and interacting with other cyclic systems. With this understanding we highlight gaps and weaknesses in the current innovation systems in Australia and propose ideas for consideration. We suggest the Australian Government has a critical role in providing leadership through policy, processes and strategic investment.

For a more detailed assessment on the importance of innovation to the Australian dairy industry and discussion of specific challenges, please refer to the industry's submission to the Review of the National Innovation System.

The major themes in our response to the review are that:

- ▶ Successful innovation is commercially led, responsive and adaptable.
- ▶ Innovation on a national scale requires strategic investment in knowledge/technology platforms and capability.
- ▶ Government investment should aim to overcome barriers and fill gaps that stifle innovation. It should assist in reducing the commercial risks associated with bringing new technologies and ideas to market and should facilitate collaboration.
- ▶ A government investment strategy should include consideration of a number of dimensions including risk profile, benefit to Australian industry and economy, and time horizons.
- ▶ Commercial and industry organisations are strategically investing in innovation, often in a manner that attracts support from government. There are many common interests in these investment relationships, especially where combined investments in pre-competitive and industry-good activities have national economic, social and environmental benefits.
- ▶ Government should continue to have a critical role, primarily as an enabler of innovation. Investment decisions by governments lead to clear signals of prioritisation of effort, capacity building and infrastructure use to reduce risk at pivotal moments in the innovation process, and to collaboration and networking.

Regulatory issues

Like all industries dairy's commercial operations are affected by the regulatory environment in which it operates (both domestically and internationally). The cumulative weight of regulation will clearly affect business performance and outcomes. In its recent submission to the Productivity Commission second annual review of Regulatory Burdens on Business, the dairy industry outlined a number of domestic regulatory issues that can act to hamper the commercial performance of Australian dairy businesses in both the local and export markets. A copy of the submission can be provided on request) but the following comments highlight some areas of industry concern in relation to the potential impact of regulation on export performance.

- ▶ **Regulation of chemicals and their usage.** Authorities should develop minimum effective regulation based on science and reflecting risk assessment. Increasing requirements for control and training, even where chemical use has been satisfactory over decades, are direct costs that should be carefully examined.
- ▶ **Regulation by national systems with blanket rules.** While rural industries often seek uniformity across jurisdictions in principle, having 'one system' can also raise productivity issues where practices in sizeable parts of industries differ for efficiency, commercial and environmental reasons. Examples discussed include the Animal Welfare Strategy Livestock Transport Standard, and QA programs.

- ▶ **The trend to regulated programs requiring actions to ‘save’ energy, water, or waste**, instead of using marketplace mechanisms. In particular, the Environment and Resource Management Efficiency Program in Victoria, and the stringency and reporting requirements of the NEPM (National Environment Protection Measure) for Used Packaging Materials.
- ▶ **Increasing costs of reporting to authorities** for a range of national and state programs including the National Pollutant Inventory and Greenhouse regimes.
- ▶ **Greenhouse reporting and emissions trading** as a large, emerging regulatory arena. The Dairy industry is expecting Australian governments to show their commitment to principles of ‘minimum effective regulation’ and ‘good regulatory practice’ in developing these potentially high-impact regulatory regimes.
- ▶ **Food health debate, policy and standard making is increasingly complex.** The Dairy Industry seeks to be fully involved in reviews of present and future systems. Current issues for Dairy include: Revision of Government mandated Population Dietary guidance, Nutrition and health claims, Mandatory Fortification, and Regulation of Novel Foods. There is a strong need to streamline food regulation regimes
- ▶ **Difficulties with alignment, integration and duplication of food hygiene standards**, particularly the Australian Dairy Primary Production and Processing standard and parallel export rules. A more general but equally important issue is development of Guidelines that extend beyond actions needed for basic compliance with standards

Trade development programs and services

The discussion paper sought comment on the effectiveness of trade development programs such as the Export Market Development Grant Scheme.

Australian dairy exporters are quite diverse ranging from niche specialty cheese exporters to major manufacturers. This diversity makes it difficult to make definitive comments on the value of specific programs to industry. Some general comments however are set out below.

Many trade development programs such as the EMDG scheme are currently targeted at Small to medium enterprises.

The national industry service body, Dairy Australia, is recognised as an industry body for EMDG purposes. For the past four years it has participated in the scheme to help develop an active preference for Australian dairy product in key export markets in North Asia.

However, over 90% of Australian dairy exports would come from large export manufacturers, who operate outside the scope of the EMDG scheme. There is no equivalent program for larger exporting companies and exporters.

Industry recognises that schemes such as EMDG can advance the ability of small firms to develop value adding niche markets overseas.

But it also believes that government trade development programs should also seek to encourage and support the market development objectives of existing exporters. Therefore a key principle in the future development of such schemes should be the extent to which they will work to increase the volume and value of Australian exports. Increasing the number of exporters is of itself not a key objective.

One way to help small companies become aware of the government resources available to support export efforts is to create a real one stop shop – one that covers the services of all Federal and State Departments. These services are likely to be useful for small companies wanting to export for the first time and for a national body such as Dairy Australia which is looking at ways to achieve industry trade development objectives. They will be less relevant to larger companies which are well established in export markets and which are well aware of the services provided by Dairy Australia and government agencies.

Maximizing the Effectiveness of Trade Development Resources

Dairy Australia works closely with Austrade in a number of countries in the implementation of overseas market development programs, in gathering local intelligence and in solving short term market access barriers of a technical nature. Although the quality of service can vary depending on the quality of the locally engaged staff we generally find that Austrade is very effective in all three areas. Individual companies work directly with Austrade on specific market access issues which are not relevant to other Australian companies.

The dairy industry works with DFAT to promote long and short term trade policy objectives. We generally find that DFAT officers overseas (and overseas officers of other Departments such as DAFF and Customs) are very responsive to requests for assistance in overcoming short term trade barriers.

As the dairy industry is a national industry, most of the industry dealings are with Federal or national bodies. As a result, the industry has had minimal dealings with State or Territory overseas offices.

We would suggest that, in order to maximise export performance, a closer alignment between State and Federal initiatives would be beneficial to national industries, like dairy.

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Related Submissions

Australian Dairy Industry *Submission* to Productivity Commission Second Annual Review of Regulatory Burdens on Business.

Australian Dairy Industry Submission to the National Innovation Review, Department of Innovation, Industry, Science and Research.

Australian Dairy Industry Submission to the National Review of Emissions Trading Schemes.

Australian Dairy Industry Submission to the Quarantine and Biosecurity Review, Department of Agriculture, Fisheries and Forestry.

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