

5 April 2017

Committee Secretary
Joint Standing Committee on Foreign Affairs, Defence and Trade
PO Box 6021
Parliament House
Canberra ACT 2600

Dear Secretary,

Australia's trade and investment relationship with the United Kingdom (UK): joint submission on behalf of the Australian dairy industry by the Australian Dairy Industry Council and Dairy Australia

The Australian Dairy Industry Council (ADIC) is the dairy industry's peak policy body. It co-ordinates industry policy and represents all sectors of the industry on national and international issues through its two constituent bodies: Australian Dairy Farmers Ltd (ADF) and the Australian Dairy Products Federation (ADPF). The ADIC aims to foster, promote and protect the interests of the Australian dairy industry by driving a whole of industry approach to dairy policy and its development.

Dairy Australia is the national services body for dairy farmers and the industry. Its role is to help farmers adapt to a changing operating environment, and achieve a profitable, sustainable dairy industry. As the industry's Research and Development Corporation (RDC), it is the 'investment arm' of the industry, investing in projects that can't be done efficiently by individual farmers or companies.

The dairy industry is one of Australia's major rural industries. Based on farm gate value of production, dairy is ranked third behind the beef and wheat industries. There are approximately 6,100 farms producing an estimated 9.539 billion litres of milk in 2015-16. The dairy industry is one of the leading rural industries in terms of value-adding, contributing \$13.7 billion at wholesale to the economy. Approximately 38,000 people are directly employed on farms and in dairy manufacturing. Dairy processing and service industries are largely based in rural areas, generating significant employment and economic activity in regional Australia.

The dairy industry is the fourth largest exporter in the world behind New Zealand, the European Union (EU) and the United States, with an approximate 6% share of global trade, on a milk equivalent basis in 2015-16. The total value of dairy exports in 2015-16 was just under A\$3 billion. The major regional export destinations are ASEAN, East and North Asia and the Middle East.

In response to the terms of reference the following comments are submitted on behalf of the dairy industry.

Australian origin dairy product exports to the United Kingdom (UK) are negligible; totalling 15 tonnes in 2015, including one tonne of cheese. In the ten-year period 2006 to 2015 UK imports of Australian origin dairy products peaked at 3,281 tonnes in 2007 before sliding. Imports of cheese accounted for 90% of the total over the ten-year period; averaging 1,211 tonnes per annum.

This trade is occurring in the context of the UK's position as the second largest, after China, dairy importing nation. For example, in the period 2006 to 2015, if intra-EU trade is included, the UK 'imported', on average, 339,660 tonnes of cheese per year. Of this total the other EU member states supplied 92%.

On a value basis, the dairy trade relationship with the EU is even more pronounced: 98% of the UK's dairy imports are sourced from the EU, mainly cheese and butter from Ireland and France, while 72% of British dairy exports are destined for the EU¹.

At the same time, the dairy trade relationship between Australia and Britain is becoming increasingly asymmetrical with UK origin exports to Australia increasing from 1,028 tonnes in 2006 to 2,075 tonnes in 2015. Cheese constitutes the largest product group.

The dairy trade imbalance is the opposite of historical trade: that prior to joining the European Economic Community (EEC) on 1st January 1973 the UK was easily Australia's largest market for butter and a major destination for cheese, primarily cheddar, exports. For example, in the six-year period 1967-68 to 1972-73 the average volume of bulk butter and cheddar exports were 46,270 tonnes and 8,778 tonnes respectively.

The dairy trading relationship collapsed in the second half of 1972 as the UK prepared for entry into the then EEC; subsequently only a small volume cheese quota, initially of 3,500 tonnes, delivered preferential, country specific access.

It is worth noting that although Australia lost its largest market for butter, New Zealand was able to keep its access to the UK market to a greater degree than Australia.

In the absence of a trading relationship there has been minimal incentive for bilateral investment in the dairy supply chain.

Possible implications for Australia's dairy trade and investment relationship post-Brexit are complex. Whilst the UK will negotiate a trade agreement with the EU-27 it is also required to establish a schedule for multilateral (WTO) access as their membership of the then EEC predated by over two decades the conclusion of the Uruguay Round Agreement. The two negotiations will run in parallel, once Article 50 is triggered.

Australia along with other major dairy exporting nations; New Zealand (number 1) and the United States (number 3) has expressed an interest in negotiating a bilateral agreement with the UK. The sequencing of bilateral negotiations may have an important bearing on the quality of dairy market access, noting that:

- The UK is milk deficit nation, with the self-sufficiency ratio, depending on seasonal conditions, as low as 88% meaning it will remain an important importer of dairy products, though:

¹ AHDB: Horizon Market Intelligence; 'What will an UK/EU trade relationship look like post Brexit'; 8th July 2016; page 2.

- The evolution of regional and global value chains means that the UK is also a modest sized exporter of milk, cream, cheeses including specialty such as Stilton and whole milk powder with the main destination being the other EU member states
- Australia, New Zealand and the United States will likely all seek major liberalisation of dairy product trade; preferably a similar outcome to that agreed with the EU
- The EU will seek to retain preferential access for dairy products to the UK market, post-Brexit and specifically at the current zero tariff rates, and
- The UK dairy sector is enmeshed with that of the continental EU member states and with Ireland:
 - The latter's major export destination is the UK, especially for cheese (cheddar) and butter. A change in the current free trade scenario could have major implications for the Irish (both Erie and Northern Ireland) industry in terms of cross border movement of milk, export flows and product mix
 - Whilst the dominant export destination for UK origin dairy products is continental Europe, if tariffs are reintroduced this could result in increased emphasis on exporting to third country markets such as Australia

The UK will also need to resolve its negotiating priorities and where Australia stands in the pecking order compared to the United States, China, India, Japan, South Korea and other countries/regions. It is worth noting that ASEAN is a long-way from clarification, and Brexit needs to be completed before the UK can formally enter into bilateral negotiations.

Similar to the UK the EU-27 is required as a result of Brexit to renegotiate its WTO schedule. The Australian dairy industry would like both the EU-27 and UK schedules to mirror (be identical) to the existing EU WTO schedule. For dairy, a 'mirror' outcome would entail doubling country specific quota access for Australian origin cheddar and processed cheese; to a combined total of 8,422 tonnes².

Australia's dairy trade relationship with the EU mirrors that with the UK, though the asymmetrical imbalance is substantially higher. EU-27 imports of Australian origin dairy products totalled 137 tonnes in 2015, down from 15,090 tonnes in 2006. Refer to Attachment I for an overview.

With respect to investment, though, the EU-27 is at opposite ends of the spectrum. Two of the world's largest dairy companies: Lactalis (headquartered in France) and FrieslandCampina (headquartered in The Netherlands) are involved in processing milk in Australia whilst the trading company Louis Dreyfus, headquartered in Amsterdam, is a joint investor with Midfield Group in a new milk powder plant at Penola, South Australia. Stage one is set to come online in mid-2017.

The implications of Brexit for the dairy trading and investment relationship with the EU are unclear; the current negligible volumes of imports mean that reprocessing of Australian origin bulk dairy products into value-added consumer foods for re-export to continental Europe is non-existent. Growth of value supply chains will depend on the degree of liberalisation of an Australia-UK free trade agreement and the relative attractiveness of the UK and EU-27 as an export destination for Australian origin dairy products.

² The current EU-28 WTO quota of 4,211 tonnes is split between 3,711 tonnes for table cheddar and 500 tonnes for cheese for processing.

Barriers to dairy trade prior to Brexit are major; both from tariff and non-tariff perspectives. Under the current WTO access country specific access rights into the EU-28 consists solely of 4,211 tonnes of cheese. This is totally unacceptable commercially as:

- EU origin cheeses have duty and quota free access into Australia, with the exception of, semi-hard cheese varieties such as Gouda, Edam and cheddar that compete, especially the latter with domestic origin make:
 - The out-of-quota tariff of A\$1,220/tonne has never been applied as the domestic demand is for EU origin specialty varieties
 - Refer to the Attachment II for a brief overview of the cheese and curd import quota scheme
- The quota volume is paltry and fixed until either the Doha Round, or a bilateral agreement, is implemented
- Access for cheese is restricted to two tariff lines³
- An in-quota tariff rate of Euros 170/ tonne is applied (another impediment to trade)
- Quota administration is by the EU Commission rather than the Australian government as occurs for dairy quotas under the Australian-United States FTA adding to an inflexible system
- Time consuming physical inspections are required to approve Australian manufacturing plants for exporting to the EU, rather than having in place a mutual recognition agreement:
 - Noting Australia's exemplary food safety track record and
- There are no country specific quotas (CSQs) for other Australian origin dairy products such as butter and milk powders

A trade agreement with the UK offers the opportunity of substantially expanding dairy exports from Australia to the UK provided that:

- Commercially meaningful liberalisation of dairy products occurs from date of implementation with a substantive compound annual growth rate
 - Dairy product coverage is comprehensive
- Quotas are a transitory measure to free trade within a short time frame (5 years maximum)
- In-quota tariff rates are zero and
- Non-tariff measures are based on international standards and sound science with a mandatory requirement for regulatory cooperation that can lay the basis for harmonisation of standards:
 - This will mitigate the potential for non-tariff measures to evolve into behind the border (on non-tariff barriers) to trade

Trade and investment go hand-in-hand, potentially creating a double gain for dairy sectors in both Australia and the UK. Consequently, investment clauses are sought in a bilateral agreement to encourage a mutually beneficial two-way flow subject to appropriate protections for investors; specifically, that domestic and foreign investment be treated equally in policy making and by the legal system.

³ a. 0406 90 01: Cheese for processing; and

b. 0406 90 21: Whole Cheddar cheeses (of the conventional flat cylindrical shape of a net weight of not less than 33 kilograms but not more than 44 kilograms and cheeses in cubic blocks or in parallelepiped shape, of a net weight of 10 kilograms or more) of a fat content of 50 percent or more by weight in the dry matter, matured for at least three months.

A gold standard agreement for dairy (and agricultural) produce is epitomised by access that results in free trade (zero tariffs on all products and no quotas), no Technical Barriers to Trade and a mutually compatible regulatory environment.

The risks, from an Australian dairy industry perspective, are:

- Potential expansion of Geographic Indications of origin (GIs);
- Competition from the three largest dairy exporting nations; namely New Zealand, the EU-27 and the USA;
- Farm payments, including for meeting 'greening' (environmental and sustainability) standards. UK farmers have been guaranteed CAP (Common Agriculture Policy) payments in full up until the end of 2020:
 - UK dairy farmers, depending on location within the four regions (England, Northern Ireland, Scotland and Wales) rely on government payments for between one-quarter and one-half of their income.
- Sanitary and Phytosanitary (SPS) matters, for example use of the precautionary principle.

The role of Australian governments is crucial, especially Federal in securing a commercially meaningful free trade agreement with the UK from entry into force; with agriculture at the heart.

The UK was an historically important market for the Australian dairy industry (as mentioned earlier) and prior to 1973 it was the largest market for butter. It is unlikely, in the short to medium term, that the UK will be such a major market. The Australian dairy industry's major markets are in Asia and the industries current priorities reflect this. Key dairy industry priorities in 2017 include, among others, concluding the Indonesia – Australia Closer Economic Partnership Agreement and reducing Non-Tariff Barriers to Trade.

If you have any questions or wish to discuss this submission please do not hesitate to contact me or the relevant contact listed below.

Yours sincerely



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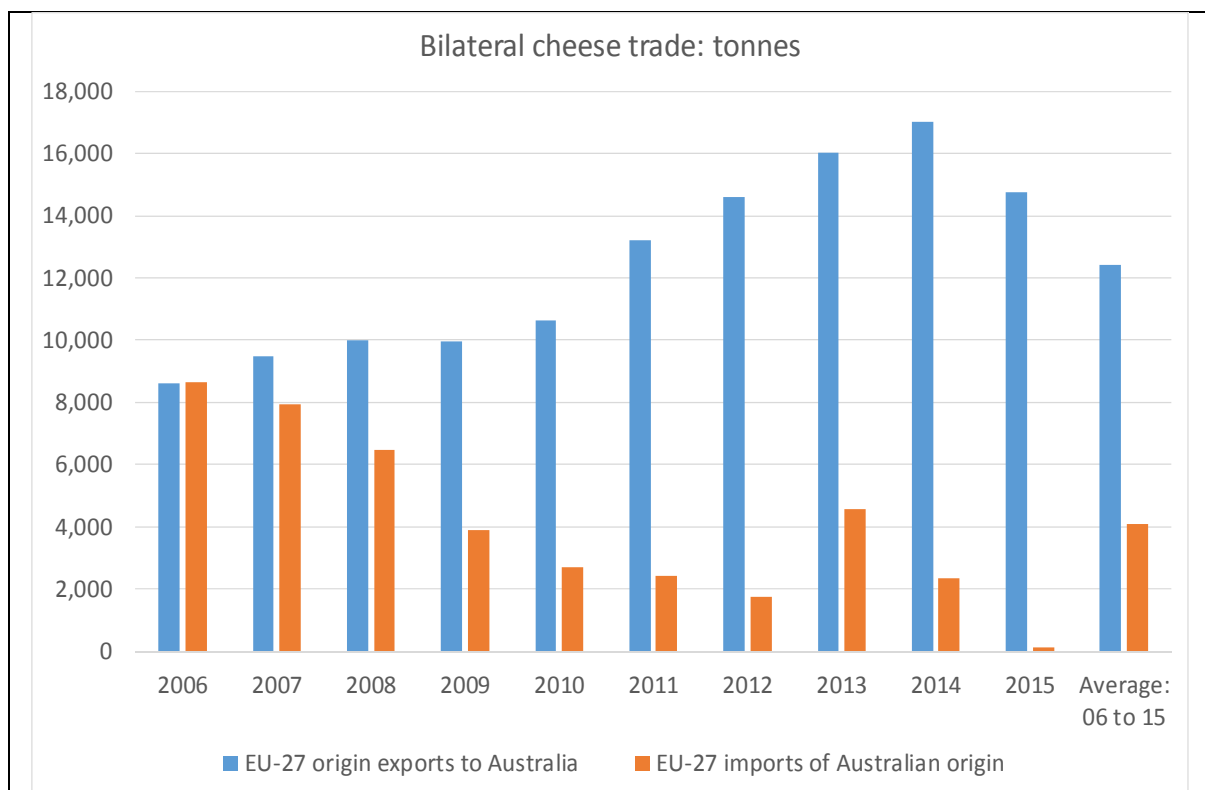
Attachment I: Overview of cheese trade between Australia and the EU-27 (minus the UK)

Australia’s dairy trade relationship with the EU mirrors that with the UK, though the asymmetrical imbalance is substantially higher. EU-27 imports of Australian origin dairy products totalled 137 tonnes in 2015, down from 15,090 tonnes in 2006.

Cheese was the major dairy product imported. The precipitous decline largely reflects:

- Declining export availability from Australia since 2001-02
- Relatively easier access into other destinations (covering both tariffs and non-tariff barriers)
- Growing price competitiveness of EU origin and from the
- Perspective of Australian dairy manufacturers:
 - EU quota underutilisation
 - In response to customer requirements changing product mix with less emphasis on exporting butter and cheddar
 - More attractive returns in other markets and
 - Importance of maintaining relationships with major buyers in South East and East Asia and Middle East markets
 - Refer to the chart below

In contrast exports of EU-27 origin dairy products to Australia have expanded considerably over the ten-year period (2006 to 2015), more than doubling from 18,420 tonnes to 37,161 tonnes. Cheese is the mainstay accounting over the period for 42.4% of imports. The value of EU origin dairy imports, in 2015, reached A\$257.6 million compared to A\$167.2 million in 2006.



Attachment II: Australia's cheese and curd import quota

European Economic Community (EEC) restrictions on imports of cheese were the catalyst for the introduction, by Australia, of the cheese and curd quota scheme (quota). The EEC use of export subsidies for dairy products was also a consideration.

During the mid-1980s the EEC had accumulated enormous stockpiles of price-supported dairy products (butter and skim milk powder or SMP). This was as a result of the EC Common Agricultural Policy being too generous in relation to market realities. To make a substantive dent in their burgeoning stockpiles huge volumes of subsidised butter and SMP were exported to the then largest import market, the USSR – particularly in the period 1986 to 1988.

This had the effect of severely depressing dairy commodity prices globally. During this period, Australia exported between 25% and 30% of national milk production.

The lack of market access for cheeses of Australian origin into the EEC, and their market distorting export sales were taking place at the time of the introduction of the Kerin Plan in Australia. The Kerin Plan, dating from mid-1986 was designed to establish higher domestic prices for Australian dairy products, and facilitate market signals to encourage the emergence of a more efficient and export competitive Australian dairy sector.

As a result, the quota, introduced in 1986-87 reflected the commercial and political reality that as the Australian dairy industry was reforming the domestic market required shielding from unfair competition by specified, subsidised EC cheeses; particularly semi-hard cheese varieties such as cheddar; the largest volume product.

The financial year quota is 11,500 tonnes with a small in-quota tariff of \$96/ tonne has been increasingly filled in recent financial years, though, not exceeded as a result of the competitiveness of New Zealand and US origin semi-hard cheeses and consumer demand in Australia for high value EU origin specialty cheeses. The latter fall outside the quota system. Exchange rate movements also play a role in relative competitiveness.