Australian Dairy Industry Council Inc.

29th April, 2004

The Secretary
Senate Select Committee on the Free Trade Agreement between Australia and the United States of America
Suite S1.30.1
The Senate
Parliament House
CANBERRA ACT 2600

Dear Secretary,

Please find attached a submission from the Australian Dairy Industry Council, on behalf of the Australian dairy industry, regarding the proposed Australia – United States of America Free Trade Agreement. The ADIC is an organization representing the common interests of the Australian Dairy Farmers Ltd. and the Australian Dairy Products Federation.

If there are any queries or further information required regarding this submission please do not hesitate to get in touch.

The ADIC welcomes the opportunity to provide verbal evidence to the Committee at their public hearing in Canberra on 5 May 2004.

Yours sincerely,

A. J. Burgess
Chairman

Level 6, 84 William Street, MELBOURNE, VICTORIA 3000
Phone: 03 9642 8066
Fax: 03 9642 8166
Email: jmcqueen@dairy.com.au

Proposed Australia – United States Free Trade Agreement:

Submission by the Australian Dairy Industry to the Senate Select Committee

The Australian Dairy Industry wishes to thank the Chairman and members of the Senate Select Committee for providing the opportunity to comment on the proposed free trade agreement (FTA) between Australia and the United States of America.

The Australian Dairy Industry (ADI) urges all members of Federal Parliament to support the FTA.

While the Industry is disappointed that the FTA did not ultimately include free trade in dairy products, the Agreement does lead to an immediate <u>four</u> fold increase in Australia's quota access for dairy products to the USA. The agreement, therefore, contains commercially tangible outcomes from Year 1 of implementation. The proposed FTA access will grow at an average compound 5 per cent per year.

The ADI now finds itself in a <u>favourable</u> competitive position of being "the first cab off the rank" among the competing regional agreements[1], notably the Free Trade Area of the Americas and multilaterally. Australian manufacturers have the opportunity of either cementing or establishing strong client relationships ahead of rivals.

Value adding is potentially an important gain from greater access. The United States market is increasingly sophisticated in terms of consumer tastes (e.g. specialty cheese) and health ingredients – the latter reflecting the growth in demand for bioactive foods.

Growing demand for dairy

Greater access under a FTA offers significant opportunities for the Australian dairy industry to grow demand for dairy products in the United States through new product development and marketing. This will in turn, create jobs in Australia and the United States in warehousing, distribution, retailing and in downstream, value-added food processing.

Background to the Dairy Industry

Dairying makes a major economic and social contribution to coastal or near-coastal communities ranging from Far North Queensland to SW Western Australia including northern Tasmania and inland communities located in central NSW, the Riverina and northern Victoria.

[1] The Chile-U.S. FTA offers small gains in quota access until the cliff edge (free trade) occurs in year 12 of implementation i.e. 2015.

Dairy is the largest processed food industry in Australia creating skilled and semi–skilled jobs in farm and factory service industries, manufacturing, distribution and at point of sale (retail or food service). Dairy is also Australia's largest processed food exporting industry, representing about 30 per cent of Australia's processed food exports. Improved access to the wealthy and sophisticated United States dairy product and food processing market will create incentives for Australian exporters to grow demand for Australian dairy products through providing specialized, tailored products, ingredients and services.

Dairy in 2002/03 was Australia's third most valuable agricultural industry at the farm gate with a value of $2.8 billion. The industry is also the largest value adding food industry with an ex factory value of $8.5 billion. Dairy creates jobs with 10,600 dairy farmers and 35,000 to 40,000 downstream workers and further indirect employment of up to 150,000 in ancillary industries such as distribution, warehousing and services. The vast majority of these jobs are created in rural and regional communities.

Trade agreements per se

Trade agreements have played an important role in the development of the ADI. The Closer Economic Relationship with New Zealand, signed by the Hawke Government in May 1983, and the resulting Kerin (dairy reform) Plan were instrumental in laying the groundwork for the emergence of a modern, globally competitive dairy industry. The Uruguay Round of WTO negotiations imposed limits on export subsidies and increased market access which further boosted Australian dairy's ability to grow as a profitable export oriented industry.

Commercial Environment

The commercial environment facing dairy products is increasingly competitive. The growing sophistication of vegetable based fat and protein substitutes, consumer health issues and the globalisation of the food supply chain are three forces reshaping demand, sourcing and pricing issues for the dairy industry. Being competitive with substitutes on quality, functionality and price grounds is an increasingly important criterion in retaining sale volumes and building a competitive advantage for dairy products. Trade reform, by allowing sourcing from the most appropriate location is an essential element in creating and maintaining a competitive advantage for dairy.

Dairy Farming Business Environment

Over the twenty years to 2001/02 Australia's milk production almost doubled. However, the very severe drought has led to a drop in production of about 10 per cent since that time.

According to ABARE, dairy farmers were the worst affected agricultural industry from the impacts of the drought with loses averaging $76,600 in 2002/03.

The severe financial and production impacts of the drought will mean it will be three to five years before production recovers to the record levels of 2001/02 and can resume a projected three per cent annual growth rate.

The sustainable growth of Australian milk production depends almost solely on farm productivity gains given the very limited additional supply of suitable grazing land and water. Productivity gains, in turn, are determined by milk production per cow (genetics, feed management and feeding practices) and the number of cows (fertility rates and capacity to feed additional stock numbers). Seasonal conditions and availability of irrigation water play a crucial role in the feed supply. Looking ahead the most feasible growth rate for Australian milk supplies is 3 per cent annually.

The high costs of the drought have been compounded by relatively low farm gate returns for dairy farmers over the past year. These low farm gate returns have been very adversely impacted by the significant increase in the value of the AuD$. While world market prices over the past year have been about the same as or higher than they were in 2001/02, farm gate prices have dropped in that period from about 33 cents per litre down to about 25 cents per litre as the AuD$ has appreciated from about 50 cents U.S. to a high of around 80 cents U.S. in the first quarter of 2004.

The twin impact of the drought and low farm gate prices has resulted in substantially reduced cash flow and farmers incurring much greater debt. This has reduced both the confidence and the ability to make (at least in the short-term) the investment needed to expand production, boost productivity and resulting profitability. The FTA with the USA has provided positive news for the future of dairy farming.

Manufacturers have also felt the impact through lower milk deliveries reducing export milk availability. This has impacted on factory efficiencies and through-put costs and, ultimately, company profitability.

Export Focus of the Dairy Industry

Over the past ten years Australian dairy exports have grown by about 2.5 times to a total value of about $2.5 billion in 2002/03. The Australian dairy industry is an export success story, exporting to over 100 countries and with approximately two-thirds of exports by value going into near neighbour markets in South East and East Asia.

Therefore, the long–term prosperity of the Australian Dairy Industry is linked to export markets and international market access. The domestic market is mature and will provide only limited growth through population growth and through product innovation. Australia is the third largest dairy exporter after New Zealand and the European Union.

The four fold increase in quota access through the FTA in year one, compared to current quota access under the Uruguay Round agreement, creates opportunities for more dairy manufacturers to benefit from the proposed Agreement.

The new access to the United States market is broad based with European style cheese (Italian varieties, Gouda and Edam and blue mold), ice cream, (frozen) cream, milk powders (both skim and whole), Goya cheese and other dairy products added to country (Australia) specific access.

The country–specific nature of this new access offers Australian manufactures a unique opportunity to grow demand for dairy in the United States with innovative, customer tailored products before competitors can secure increased access via either regional agreements or multilaterally through the WTO.

By expanding quota access on an annual basis the proposed agreement also allows Australian manufacturers to develop a brand presence for their high quality dairy products into the wealthiest consumer market in the world.

Impact of Proposed Agreement on the Australian Dairy Industry

The value of dairy exports to the United States in Year 1 is estimated to grow by between A$50 million and A$60 million. The exact export income gain is difficult to quantify because of the impact of a number of variables including but not limited to;

- Currency movements between the AUD and U.S. dollar,
- Movements in U.S. dairy wholesales prices which can be volatile, and
- The individual and collective ability of Australian quota entitlement holders to secure market premiums

A competitive advantage (compared to other exporters to the United States market) is that <u>all</u> of Australia's country-specific in-quota tariff rates will be set at zero from day one of implementation – compared to current rates ranging as high as 23 per cent ad valorem.

The compounding nature of access means that the potential for export income gains will double in about 16 years.

The social impact of the proposed FTA is beneficial from the perspective of the ADI. Compounding growth in exports to the second largest dairy consuming market in the world delivers economic (jobs) and consequent social benefits to dairy communities across Australia. Dairy is the largest processed food industry in Australia, with value adding largely concentrated in rural areas. Greater exports increase demand for skilled and semi-skilled jobs in regions where dairying and food processing form an important backbone of the local economy.

The job benefits, however, are not solely confined to regional areas. They include distribution and warehousing. Dairy is the largest single containerised shipping user of the Port of Melbourne, accounting for 9.2 per cent of total export volume in 2002/03.

Impact of Proposed Agreement on the United States Dairy Industry

However, the size of access gains needs to be put in perspective from a U.S. industry viewpoint. The U.S. dairy sector is enormous in comparison to the industry in Australia. The milk equivalent of FTA quota access in Year 1 of implementation is about 169 million litres which is miniscule compared with U.S. milk production in 2003 of 74.5 billion litres – the ratio is slightly less than one-quarter of one per cent.

On a product specific basis the increased access will comprise a miniscule portion of total U.S. production. For their three price supported products (butter, skim milk powder and cheddar) the increased access in years one and nine (projected as 2014) of the proposed Agreement will vary between one-thirtieth of one per cent and one-third of one per cent of forecast U.S. production.

Gains to the individual farmers

The cooperative based nature of the Australian Dairy Industry, where approximately three quarters of milk is delivered to cooperatives, means that farmer shareholders can be direct beneficiaries of increased access through the gains in export income. While premiums will vary over time, the potential benefit available through the agreement to flow through to a farmer, with an average herd size of about 200 milking cows, should be in the order of A$2,500 to A$3,500 in farm gate revenue in the first year.

The broad nature of the product types included in new access under the FTA means there is the opportunity for the benefits from the FTA to be available to companies and farmers across regional Australia.

Mutual Opportunity

The FTA has the potential to create not only closer commercial links between Australian manufactures and the U.S. food supply chain but to also boost links and cooperation in other areas. For example there are grounds for closer cooperation in seeking fundamental reform of multilateral agricultural trade. Sharing knowledge and collaborating on generic dairy promotion and separately addressing common on–farm issues ranging from animal health and welfare to environmental compliance holds out the prospect of boosting the performance of dairy farming in both nations. Theses contacts are at multi-layered levels ranging from industry associations through dairy companies to research organisations.

Intangible gains – Investment flows

One intangible benefit which potentially could deliver the greatest long term benefit is the incentive provided for greater two-way investment flows. The Dairy Industry has traditionally welcomed investment in its many forms (direct, joint venture or partnership) as a way of transferring technology, bringing new skills into the industry at both the manufacturing and marketing levels and opening up export market opportunities.

Stepping stone to Doha

However, it is important to note that the proposed FTA is only a stepping stone to the Industry's most important trade objective; achieving fundamental reform of world dairy product trading arrangements. The industry recognizes this is most likely to be achieved through the Doha Development Round negotiations, and will continue to work closely with Government to achieve these national objectives. We will also continue to work closely with like minded counterparts in overseas dairy industries in pursuing dairy trade reform. The Australian Dairy Industry is a founding member of the Global Dairy Alliance and is putting considerable effort into making the Alliance an effective voice for securing fundamental reform.

Conclusion

The Dairy Industry has long–term milk production growth potential of about three per cent per annum. This will directly feed into greater exports given the mature domestic market. The extent of sustainable downstream value adding and skilled job creation in regional communities where the dairy industry operates, therefore, will be heavily influenced by the quality of our access into major or potentially major export markets.

The proposed FTA with its combination of zero tariffs, greater spread of dairy product access and compounding growth in access represent important steps in the right direction from an Australian dairy perspective.

The agreement is not a panacea for the challenges currently facing the Dairy Industry. But it will give local dairy farmers and manufacturers renewed a significant short term boost and help rebuild confidence at a crucial stage of our development. It will also help us take greater advangate of Australia's undoubted international competitiveness as a dairy producer, and help underpin future prospects and sustainability of our Industry.

For these reasons, the Australian dairy industry urges all members of Parliament to support the proposed Free Trade Agreement with the United States.