Korea Australia Free Trade Agreement Negotiations

Australian Dairy Industry Submission – 27 January 2009

This submission has been prepared on behalf of the Australian dairy industry by Dairy Australia. It has been prepared in consultation with representatives of Australian dairy farmers and manufacturers in response to the Australian Government's call for submissions on a possible Australia – Republic of Korea Free Trade Agreement.

The submission urges the Australian Government to commence negotiations as soon as possible to achieve a substantial liberalisation of dairy trade between the two countries. If this is not achieved before the Korea US Free Trade Agreement comes into force, Australia's position in the Korean dairy market will be severely eroded.

Korea and World Dairy Trade

The Republic of Korea imports about 150,000 tonnes of dairy products each year with an import value of around $US 300 million. Although Korean companies are often as quality conscious as their counterparts in Japan, they also demand lower prices.

The price sensitive nature of the Korean market means that the source of imports will often depend more on price and availability than long term customer/supplier relationships. This is a key reason for Australia's share of Korean imports varying from year to year.

In a market of this nature, it is important that we not only strive to achieve any advantage that we can find but also that we ensure that our competitors (US, EU and NZ) do not have any advantage brought about by preferred access arrangements.

Tariffs

Under the terms of its Uruguay Round commitments, imports of dairy into Korea are heavily distorted by a tariff structure which makes trade in many products virtually impossible except for very small quota volumes. The Korean Government occasionally grants quotas in excess of the bound volumes. This is, however, done on an ad hoc basis and so results in spot trade rather than enabling effective commercial relationships.

Out of quota tariffs on milk powders for example are 176%. Although the quota volume of just 573 tonnes for milk powder (whether skim or whole) is very small, the Korean Government regularly allows additional quota to meet processors needs.

The 420 tonne quota for butter is not usually augmented and the tariff on butter other than dairy spreads is 89% so traders tend to look to those items which have lower tariffs. For example, there is a considerable trade in butter blends (butter mixed with vegetable oil) as it only attracts an import tariff of 8%. This trade occurs even though the end users would often prefer pure butter.

For other items, although the tariff is quite high, trade takes place which is an indication of relatively strong demand. The most notable of these is cheese which attracts an import tariff of 36%. Although Korea produces a small quantity of cheese

locally, this is insufficient to meet the demand for cheese for processing, pizza, hamburgers and the growing food service trade. As such most of Korea's cheese requirement is imported.

In 2007/08, Korea imported some 50,000 tonnes of cheese worth in excess of $US220 million. Australia only supplied about 15% of this as Korean purchasers have moved away from Australia in recent years in favour of lower priced suppliers.

Given the price sensitive nature of the Korean market, small variations in tariffs between supplying countries can, therefore, have a significant impact on the source of trade.

Should the Korea US FTA be ratified by the two Governments with the dairy sections remaining as negotiated, this will give US dairy exporters a significant advantage. This could see them effectively monopolize imports into Korea of skim milk powder, whole milk powder and butter fat products such as dairy spreads, butter and cream. Together Australian exports of these items were valued at $35 million per year in recent years.

It would also see an erosion of Australia's position in the cheese market. The US would have duty free access for 7,000 tonnes of product which it is expected would be leveraged to gain a much larger share of that market segment.

The KORUS agreement has shown that Korea can negotiate an agreement which offers commercially significant volumes of trade in key dairy products up front with total elimination of all dairy tariffs over time. An analysis of the dairy provisions of KORUS is at Attachment 1.

The Australian dairy industry requests that Australian dairy achieve at least the same level of access as the US has negotiated under KORUS – that is commercially meaningful quantities of duty free access for the key products up front and eventual elimination of all tariffs on dairy trade.

Non Tariff Barriers

The Korean Government has in the past had sufficient policy control over import volumes by simply using the bound tariffs. It has not, therefore, needed to resort to non-tariff barriers to keep imports out to protect the dairy industry. There are, however, a number of non-tariff barriers that are in place for historic or institutional reasons.

Food Standards

Dairy exports to Korea are occasionally held up because they fail tests on arrival or because they fail to meet the Korean Food Code in some other way. In recent years the incidence of this has diminished as Korean food standards and practices have been brought in line with international practice.

The Korean Food and Drug Administration has also been charged with the task of facilitating rather than inhibiting trade. In recent years the KFDA has introduced a system of pre-export certification which reduces the risk of product being held up on

arrival. This has proven useful for products such as some infant formula products which fall under the KFDA jurisdiction.

However, the KFDA only has jurisdiction over food which is not considered to be directly linked to local agriculture. Most dairy products do not, therefore, fall under the KFDA jurisdiction and so are subject to inspection and testing by the National Veterinary Research and Quarantine Service. These products are not, therefore, eligible for the pre-shipment approval procedures offered by KFDA for other food products.

The Australian dairy industry requests that dairy products be eligible for the same kind of pre-shipment approval that the KFDA offers for other food imports.

Unlike the KFDA, the NVRQS (as an instrument of the Department of Agriculture) is often more interested in stopping trade than facilitating it.

NVRQS is very slow to address issues when requested to do so by the Australian Government. For example, Korea still requires unnecessary tests for *clostridium perfringens* in hard and semi-hard cheese. Numerous representations on *clostridium perfringens* over the past 5 years have not resulted in any meaningful movement on this issue.

As it is, however, generally believed by importers that the Korean Government is not implementing this kind of practice to stop trade but to protect public health, a more constructive approach might be the establishment of a more effective dialogue process to move these kinds of issues forward.

Korea has in recent years been revising many of its food standards and testing requirements. Usually, the first advice that Australia gets of proposed changes is when they are notified to the WTO SPS Committee. Often, however, some of the issues raised in their notifications could be addressed more easily if the new standard were discussed informally and bilaterally with exporting countries such as Australia before they reach the stage of being notified formally to the WTO.

The Australian dairy industry requests that regular Government to Government meetings be established to discuss developments in food standards and other technical issues with a view to harmonizing where possible and developing timely, commercially acceptable responses to Korea's concerns.

Distribution

The Korean dairy industry is dominated by a small number of dairy companies and cooperatives. These companies have tight control over the retail distribution of products such as milk, cream, yogurt, ice cream and cheese. This means that companies wishing to sell these products at retail level in Korea can generally only do so by working with local dairy companies.

This arrangement serves as a 'natural barrier' to imports of fresh and short shelf life products which compete against products made from local milk.

The Korean Dairy Industry

The Korean dairy farming sector is stagnant. Production and prices are controlled by Government and as such production is static and the farm gate price is one of the highest in the world. At least 70% of local milk is used for drinking milk.

About three quarters of local milk is purchased by 6 large dairy companies which not only supply the drinking milk market but are also large players in the broader dairy sector. Although some of this broader sector is supplied with cheese and milk powders from local milk, most of it relies heavily on imported ingredients. These companies need access to low cost imported ingredients to maintain financial viability. Less expensive imported ingredients in fact subsidise the high price paid to dairy farmers.

So while Korean dairy farmers argue that they can not survive if subjected to free trade in dairy products, the converse (that the companies that buy their milk can not survive without free access to dairy imports) is closer to the truth.

In recent years these companies have also started to export increasing volumes of dairy products. This would not be possible if they relied solely on expensive local milk as their main source of dairy ingredients.

More information on the Korean dairy industry, its growing export capability and its relationship with Australia is at Attachment 2.

Conclusion

Korea is one of the world's most valuable and fastest growing dairy markets. The Australian dairy industry is keen to capitalize on this growth. In 2007/08, Australian exports to Korea of $A88 million attracted an average tariff of around 30%. Accordingly exporters paid an estimated $A27 million in tariffs on exports of dairy to Korea. Removal of these tariffs would see a substantial increase in the profitability of trade into this market.

Moreover, removal of these tariffs would give Australian exporters a strong competitive advantage in this very price sensitive market. If the KORUS Agreement, or any similar agreement between Korea and a major dairy exporting nation, comes into force, our competitive position in this market will be eroded. This will put at threat the current trade – worth around $A90 million annually.

Moreover, if Australia were able to negotiate an FTA which offered commercially meaningful duty free access to Korea, we would be well placed to take a larger, more profitable share of the growing volume of global dairy imports into Korea which are worth more than $300 million each year. We would also be in a better position to take advantage of value added niche marketing opportunities which are obviated by the Korean tariff structure and the spot nature of quota arrangements.

The Joint Feasibility Study into a possible FTA with Korea estimates that the removal of border protection would see a benefit to the Australian dairy industry of the order of $US50 million. The Study also notes that ratification of KORUS would see considerable erosion in the value of Australian dairy exports to Korea. There is, therefore, a need to move forward and conclude this negotiation as soon as possible.

Attachment 1

Korea US FTA (KORUS)

The following provides a brief summary of the access that the US will gain to the Korean dairy market on ratification of the KORUS agreement.

When implemented most US exports to Korea will enter under sizeable quotas free of duty with all dairy products eventually achieving free trade within 15 years.

TRQs are to be offered as follows in year one with some growth until eventual elimination. The in quota tariff will be zero for TRQ trade. The out of quota tariff rate will be the bound MFN rate or the applied MFN rate (which ever is lower).

SMP, WMP and BMP (combined)	5,000 tonnes	Growth for 5 years then 3% per year perpetually
Whey powder	3,000 tonnes	Free after 10 years
Butter and Butter oil	200 tonnes	Free after 10 years
Cheese (excluding blue vein)	7000 tonnes	Free for cheddar after 10 years for other varieties after 15 years
Milk powder preparations	700 tonnes	Free after 10 years

Based on 2007/08 import figures, this would give the US duty free access for 60% of the Korean milk powder market, 15% of the cheese market, 10% of the whey powder market and about 4% of the butter market. Moreover, US exporters will be able to leverage sales from these discounts to take an even greater market share.

For non quota items the following schedule of liberalization will apply as tariffs are reduced from the current bound MFN rate to zero in equal annual stages.

Whey for feed, dairy spreads, some specific infant formula preparations (chapter 18).	Category A Free from day 1.
Cocoa preparations, Whey protein concentrate	Category D Free after 5 years
Casein	Category F Free after 7 years
Frozen cream, Yogurt	Category G Free after 10 years
Milk and cream	Category H Free after 15 years
Some infant formula preparations	Category M Free after 12 years

Free access for dairy spreads could see this product replacing Australia's exports of not only dairy spreads but also butter, butteroil and cream. Although the trade has come off in recent years due to supply issues from Australia, together these items were valued at $25 million in 2004/05.

Attachment 2

The Korean Dairy Industry

Korean dairy farmers produce a little more than 2 million tonnes of milk each year. The industry has been static, producing approximately the same volume for most of the past 10 years. Productivity improvements have, however, seen a change in the structure of the industry. As with most other dairy producing countries, this has seen a reduction in the number of farms, an increase in the size of farms and an increase in yield per cow as is demonstrated in the following table.

The Korean Dairy Farming Sector

	2002	2003	2004	2005	2006
Number of dairy farms	11,716	10,514	9,612	8,923	8,260
Number of heads of dairy cattle	543,587	518,645	497,261	478,865	464,056
Milking cows numbers	302,215	278,541	258,778	251,121	241,106
Cow per farm	46.4	49.3	51.7	53.7	56.2
Kg/head yield	7,017	7,102	7,286	7,420	7,546

Source: Ministry of Agriculture and Forestry

However, because the Korean Government effectively controls production volumes and the farm gate price, the ability to translate these improvements into real efficiencies has been minimal. It is unlikely that Korean farmers will be able to significantly reduce their costs further as they have a heavy reliance on imported feed.

In July 2008 the farm gate price of milk in Korea was 704 won/liter (about $A0.77). This makes Korea one of the highest cost producers of milk in the world. By comparison the farm gate price in Japan at the time was approximately $A0.75 while the price in the major exporting countries (EU, US, Australia and New Zealand) was approximately $A0.50/liter. With falls in international prices at the end of 2008, the current price paid to farmers in exporting countries is now even lower.

70 to 75% of Korean milk is used to produce liquid milk products with the remainder being processed into other dairy products such as fermented liquid milk, milk powder and cheese. It is probable, therefore, that the Korean dairy farming industry will seek to have its liquid milk sector protected.

Local milk is purchased by 19 local dairy processors, the largest of which are Seoul Dairy (32%), Maeil Dairy (15%), Namyang Dairy (13%), Bingrae (8%), Lotte Milk (5%) and Vilac (5%). The remaining 13 companies are regional suppliers of drinking milk.

The 6 large companies dominate the liquid milk market and are also the largest importers of dairy ingredients. Seoul Dairy, as the main manufacturer of cheese from local milk, is also the largest importer of cheese for processing and distribution with locally produced product. Maeil and Namyang are significant producers of yogurt and infant formula for which they rely heavily on imported ingredients. Bingrae's main area of business is ice cream which also relies heavily on imported ingredients.

It can, therefore, be demonstrated that imported dairy ingredients are an important component of the financial viability of the major users of local milk. Freer access to ingredients free of duty will, therefore, support their ability to continue to buy local milk rather than indicate a threat to their continued operation in this market.

Australian and Korean dairy industry cooperation

Australia is a major supplier of cheese and other dairy ingredients to both the Korean dairy industry and to other food manufacturers. The products supplied from Australia do not compete with so much as complement locally produced product.

To support this Dairy Australia runs a series of programs with the Korean dairy industry. Working closely with the Korean Dairy Industry Association (which represents all of the major dairy proprietary companies) and Seoul Dairies (the largest Korean dairy cooperative), Dairy Australia has since 1998 run a series of scholarships and seminars.

The scholarships are offered approximately every second year to people working in Korean dairy companies. Participants spend approximately 2 weeks in Australia studying dairy technology and visiting Australian dairy farms and factories. The most recent scholarship was held in June 2008. The next is scheduled for July 2009. In addition, Dairy Australia holds seminars in Korea on an as required basis. Recent seminars have focussed on technical topics such as trans-fats labelling and on broader economic issues. Dairy Australia plans to hold a seminar in Seoul on 19 May 2009 to discuss dairy food safety issues as well as developments in the Australian dairy industry and the international dairy market.

Korean dairy exports

Korea has in recent years emerged as a significant exporter of dairy products – particularly infant formula and 'dairy mixtures' which are generally milk powder formulations for toddlers, children and women. The main markets are Russia, the Middle East and South East Asia. Korea is also exporting significant volumes of ice cream (primarily to the USA) and yogurt (to the USA and Australia). The target for Korean exports to date has been Korean overseas expatriates. This is, however, changing as the Korean products are becoming known by other people in the global dairy market.

This growing trade, which was worth $US147 million in 2007 relies largely on imported dairy ingredients.

The main Korean dairy exports to Australia are yogurt (primarily the Maeil product which sells as a replacement for Yakult under supermarket home brands), ice cream and growing up milk powder mixes. This trade, worth about $US5 million annually is also based primarily on imported dairy ingredients.

Dairy imports into Australia do not attract tariff or quota controls except for the small duty levied on out of quota cheese.

Attachment 3

Trade Statistics

Australian Dairy Exports to the Republic of Korea

		Financial Year				
Data	Product Group	2003/2004	2004/2005	2005/2006	2006/2007	2007/2008
Volume (tonnes)	Butter	3,880	4,331	1,113	2,957	2,807
	Butter Blend	2,684	4,824	2,721	2,648	1,641
	Butter Oil	1,729	450	334	727	180
	Buttermilk				12	0
	Buttermilk Powder			1	1	2
	Casein	664	446	262	298	252
	Cheese	13,137	10,365	8,936	8,327	6,859
	Condensed Milk	180				296
	Ice Cream	465	14	48	117	65
	Infant Powder	7		731	853	1,119
	Lactose	1,545	1,599	221	526	1,780
	Milk	4,417	4,377	1,626	2,066	1,131
	Mixtures	1,723	271	717	79	32
	Protein	16	12		2	120
	SMP	1,415	2,936	3,774	4,559	3,181
	Whey Powder	2,024	2,301	964	652	50
	WMP	1,452	1,772	2,316	1,614	1,098
	Yogurt	161	17	1	4	7
Value (AUD)	Butter	9,240,344	11,374,474	3,547,874	7,968,334	8,978,772
	Butter Blend	5,745,228	12,527,429	7,379,234	6,136,899	5,464,791
	Butter Oil	4,249,398	1,173,554	903,705	1,903,435	633,942
	Buttermilk				101,755	19
	Buttermilk Powder			5,590	9,890	27,122
	Casein	4,837,530	4,010,673	2,730,171	2,699,072	3,705,642
	Cheese	43,578,541	38,748,146	36,209,328	31,982,750	32,574,801
	Condensed Milk	260,074				1,289,658
	Ice Cream	778,607	56,505	224,983	418,171	457,021
	Infant Powder	21,532		6,515,188	8,139,745	11,862,420
	Lactose	1,025,685	985,785	175,386	820,082	2,350,869
	Milk	6,252,187	7,387,038	2,758,136	3,179,910	1,886,923
	Mixtures	4,931,623	827,738	2,725,858	522,409	237,250
	Protein	43,416	34,451		65,316	516,137
	SMP	3,466,581	8,234,508	10,815,739	13,091,297	12,331,256
	Whey Powder	1,413,351	1,676,812	1,127,947	1,172,369	615,731
	WMP	3,722,476	5,304,987	8,061,320	5,565,311	5,601,648
	Yogurt	412,379	48,045	7,310	32,640	73,644
Total Volume		35,500	33,715	23,765	25,441	20,621
Total Value		89,978,952	92,390,145	83,187,769	83,809,385	88,607,646

Source: Australian Bureau of Statistics

Korean Dairy Exports (global)

		Calendar Year				
Data	Product Group	2003	2004	2005	2006	2007
Volume (tonnes)	Butter				21	4
	Butter Oil	4			0	
	Buttermilk	6	16		0	6
	Casein	24	23	76	24	0
	Cheese	698	293	322	230	52
	Condensed Milk	52	235	327	192	391
	Ice Cream	3,120	1,957	2,527	2,970	3,605
	Infant Powder	9,569	11,081	10,682	9,142	8,081
	Lactose	21	7	36	61	52
	Milk	6	79	7		5
	Milk Products	3	22	297	992	1,142
	Mixtures	62,068	67,699	69,964	63,013	67,752
	Protein	130	44	46	36	1
	SMP	0	1	69	114	140
	Whey Powder		59	216	65	45
	WMP		14		6	20
	Yogurt	6,527	6,656	6,488	6,965	5,778
Total Volume		82,229	88,186	91,058	83,831	87,075
USD Value	Butter				$ 48,024	$ 19,501
	Butter Oil	$ 2,941			$ 330	
	Buttermilk	$ 7,975	$ 21,020		$ 7,181	$ 6,036
	Casein	$ 87,088	$ 121,074	$ 286,871	$ 93,238	$ 3,295
	Cheese	$ 2,088,531	$ 1,116,982	$ 1,659,913	$ 1,160,669	$ 430,704
	Condensed Milk	$ 63,737	$ 286,166	$ 500,753	$ 343,883	$ 765,830
	Ice Cream	$ 7,774,852	$ 5,165,503	$ 7,458,343	$ 10,153,098	$ 13,644,525
	Infant Powder	$ 15,121,799	$ 19,147,772	$ 20,703,348	$ 19,985,418	$ 22,459,335
	Lactose	$ 48,958	$ 16,608	$ 46,300	$ 98,635	$ 134,881
	Milk	$ 7,433	$ 63,507	$ 5,057		$ 13,568
	Milk Products	$ 113,490	$ 39,301	$ 781,560	$ 2,563,014	$ 3,655,144
	Mixtures	$ 63,583,338	$ 75,744,639	$ 87,628,355	$ 85,326,584	$ 99,472,445
	Protein	$ 281,608	$ 93,069	$ 114,387	$ 220,410	$ 826
	SMP	$ 3,210	$ 3,254	$ 142,924	$ 453,810	$ 773,442
	Whey Powder		$ 118,751	$ 244,115	$ 144,812	$ 176,891
	WMP		$ 16,251		$ 11,669	$ 70,156
	Yogurt	$ 4,992,553	$ 5,379,826	$ 5,604,899	$ 6,376,113	$ 5,542,319
Total USD Value		$ 94,177,513	$ 107,333,723	$ 125,176,825	$ 126,986,888	$ 147,168,898

Source: Global Trade Information Services

Korean Dairy Exports To Australia

		Calendar Year				
Data	Product Group	2003	2004	2005	2006	2007
Volume tonnes)	Casein					
	Cheese	8	26	18	0	
	Ice Cream	46	107	220	287	448
	Infant Powder				1	
	Milk Products			20		
	Mixtures	173	231	657	406	234
	Protein			1		
	SMP		0			
	Yogurt	1,043	1,743	1,641	2,076	1,627
Total Volume		1,269	2,107	2,557	2,770	2,309
	Cheese	$ 30,255	$ 63,499	$ 43,495	$ 48	
	Ice Cream	$ 96,008	$ 275,699	$ 699,346	$ 826,465	$ 1,762,067
	Infant Powder				$ 18,320	
	Milk Products			$ 45,400		
	Mixtures	$ 251,902	$ 353,485	$ 3,180,787	$ 2,463,241	$ 1,420,363
	Protein			$ 3,811		
	SMP		$ 890			
	Yogurt	$ 915,172	$ 1,625,256	$ 1,713,484	$ 2,189,255	$ 1,861,600
Total USD Value		$ 1,293,337	$ 2,318,829	$ 5,686,323	$ 5,497,329	$ 5,044,030

Source: Global Trade Information Services