

Ministerial Response to the 2008 Dairy Quota Review Panel's Recommendations

The 2008 Dairy Quota Review Panel, comprising Mr John McQueen, Chair, Mr David Harris and Dr Sandra Welsman, was tasked with examining and reporting on the appropriateness, effectiveness and efficiency of the Tariff Rate Quota (TRQ) management arrangements for Australian dairy exports to the United States of America (US) and the European Union (EU), and to identify areas where improvements could be made.

Australia currently has access rights to country-specific and global dairy TRQs in a number of countries; however, the Australian Government only manages those to the US and EU. These TRQs were negotiated with the US and the EU through the Tokyo round of the General Agreement on Tariffs and Trade (GATT) in 1979 and the subsequent Uruguay Round of WTO agreements in 1994, as well as through the 2004 Australia-United States Free Trade Agreement (AUSFTA).

The Panel completed an intensive and widely consultative review and on 6 June 2008 submitted its *Report of the 2008 Dairy Quota Review Panel on Administrative arrangements for EU and USA Dairy Quotas managed by Australia*.

Following submission of the report, the Chair of the Panel briefed industry on the key findings of the Panel at two meetings convened for this purpose in August and October 2008. All quota stakeholders were invited to participate.

The report's primary recommendation is to adopt a new model for allocating dairy TRQs based on applicants' recent export performance, in contrast to the current model which distributes fixed allocations based on historical data. The proposed model also aims to maximise the value of the quotas to the EU and US markets by introducing provisions for small and new entrants in the initial allocation of quota; providing for an earlier return date for allocated quota no longer required; introducing appropriate penalty provisions; and providing more flexible administrative arrangements.

I agree with the broad thrust of the Panel's recommendations. The following details my response to the Panel's recommendations for TRQ management in the areas of the **TRQ management model, eligibility and access, implementation of and variations to the model and TRQ administration**.

1. The TRQ Management Model

a. The panel recommends that an application-based process should be adopted for the management of each TRQ. The application process will act as a market demand indicator and provide a mechanism for deciding whether a TRQ should be allocated or unallocated: if the aggregate amount of all applications exceeds the amount of the TRQ, the TRQ will be allocated using a performance-based formula. If not, it will be managed as First-Come-First-Served (FCFS).

I agree with the Panel's approach of an application-based process. The aggregate of all applications will then provide a measure of expected quota demand. Not allocating a TRQ

in years of low demand will free up the TRQ to be used by any entity and may therefore help to maximise the value of the TRQ.

Where an allocation is not triggered by applications, I have some concerns with the proposal to treat the entire TRQ as FCFS. Although aggregate demand is low in this situation, the companies that applied may need guaranteed access to quota so that they can negotiate firm contracts for supply. There is a case for providing these companies with the amount requested in order to provide commercial certainty. Otherwise they cannot be assured that there will be TRQ remaining later in the year to meet their contractual obligations. Representatives from the Department of Agriculture, Fisheries and Forestry will consult with industry about whether TRQs should be partially allocated to applicants when demand is too low to trigger full allocation of the TRQ.

b. The panel recommends that when a TRQ is allocated an applicant's entitlement should be determined by its export performance relative to the performance of other applicants. Specifically, it will be based on a three year moving average of performance based on exports of the product category covered by the TRQ with an equal weighting applied to global exports and exports to the TRQ market.

I agree with the Panel that annual performance-based allocations would maximise the value of the dairy TRQs for the Australian economy by including an element of reward for active, expanding manufacturer-exporters.

The Panel did not specify the precise formula to be used in calculating each applicant's quota allocation. Given the performance basis of the allocation, I believe that each applicant's share should be calculated by assigning an equal weighting to each of a) the applicant's exports of the specific TRQ category to the specific TRQ market (EU or US) as a proportion of all applicants' exports in that TRQ category to that TRQ market, and b) its global exports in the specific TRQ category as a proportion of all applicants' global exports in that TRQ category. The values used in these calculations should reflect average exports over the preceding three years.

Example:

Applicant A's share of the total TRQ for cheddar cheese to the US would be calculated on the basis of Applicant A's exports of cheddar cheese to the US over the previous three years as a proportion of all applicants' exports of cheddar cheese to the US over the same period, and Applicant A's global exports of cheddar cheese over the previous three years as a proportion of all applicants' global exports of cheddar cheese over the same period. An equal weighting would be given to exports to the US and global exports.

$$\text{Applicant A's share} = \left(\frac{\text{Applicant A's US cheese exports}}{\text{All applicants' US cheese exports}} + \frac{\text{Applicant A's global cheese exports}}{\text{All applicants' global cheese exports}} \right) / 2$$

Note: the above equation would be based on a 3 year rolling average of export data

I agree with the Panel that the *volume* of exports is an appropriate measure because data is readily available and reliable. By contrast, data for export *values* is not available in a form that is segregated by quota category or by company. Using values would rely on self-

reporting by companies. This would require auditing and validation which is likely to add significantly to administration costs.

The use of *domestic production* as a measure of performance is also problematic because data is not readily available and would also rely on industry self-reporting and associated auditing and validation. Additionally, production is not a useful indicator of propensity to export and could skew the allocation to non-exporters, opening a market in the sale of quota.

I agree that export performance should relate to exports of products of the same type as the TRQ category. The EXDOC database supports this approach because most Australian dairy exports are classified by an Australian code: the cut code. For the purposes of obtaining export data, each Australian cut code can generally be assigned to a TRQ.

I agree that a 3-year moving average of performance is preferable to a shorter period because it will smooth out the impact of occasional poor years of performance resulting, for example, from unexpected factory closures or temporary disruptions in export markets.

I support the equal weighting provided to performance in the TRQ market and the global market. As noted by the Panel, the inclusion of performance in the TRQ market will recognise the efforts of quota holders who have invested in product development, marketing and the establishment of relationships with distributors. Including the global market will help to open the quota market to companies trading in other markets and seeking to expand their export business. The small size of quota markets relative to global shipments means that a lower than equal ratio for the TRQ market would unduly penalise those companies that have specialised in building commercial relationships in the quota market.

c. The Panel recommends that where a TRQ is allocated any unused quota will be automatically reclaimed on 15 June if the company has not provided evidence that the quota will be used. The returned quota will be managed on a FCFS basis.

I agree with the Panel's recommendation noting that this is similar to existing provisions but with an earlier return date (currently 23 August). Quota return provisions are essential to ensure quota mobility and the opportunity for the maximum TRQ to be used each year. The earlier return date provides access to quota in an FCFS pool for a wider range of exporters for six months of the quota year, as there are no restrictions on access in FCFS pools (ie. exporters who do not manufacture product will be eligible to access the returned quota).

d. The panel recommends that to ensure the effectiveness of these provisions a penalty will apply to all quota that remains with a company after 15 June but is unused by the end of the quota year¹.

- **This penalty will be a kilogram for kilogram reduction in allocation the next time the company is allocated a share of the same TRQ.**
- **Transfers of unused quota would move the penalty liability to the transferee.**

¹ However, a company's allocation of quota from a particular TRQ will be deemed fully used if at least 98% of the company allocation has been shipped (for TRQs less than 3000 tonnes) or 99% of allocation has been shipped for TRQs of 3000 tonnes or above.

- **However, if the transferee is an entity ineligible for allocation (eg. a trader), the penalty will remain with the transferring entity.**

I agree with the need for a penalty, which reinforces the effective operation of the earlier quota return date and supports the mobility of quota to those who can best utilise it, maximising the use of the quota. Without a penalty there would be no incentive for returning quota to the FCFS pool rather than letting it sit unused. I agree with the penalties recommended by the Panel.

e. The Panel does not consider a minimum allocation is appropriate or necessary in this model other than to allocate down to the lowest practical amount being one kilogram².

This recommendation is a departure from current arrangements that have minimum allocations of either 10 or 20 tonnes. I agree with the recommendation because in most TRQs, opportunities may arise for small operators to develop niche markets for high value products that can be facilitated by access to small volumes of quota. I also agree with the Panel that there should be an exception to this rule for the US supplementary TRQ (see footnote 2 and discussion at 3.f).

f. The Panel recommends provision should be made for small operators and new entrants (SNEs) when a TRQ is allocated³. Those companies with an allocation below a threshold of 10 tonnes (including new entrants) should be able to share in a small amount of additional quota set-aside for this purpose. SNEs will receive their allocation plus an equal share of the set-aside amount.

- **Final allocation will be no higher than 10 tonnes or quantity requested.**
- **The amount of the set-aside for each allocated TRQ should be 2% of the TRQ for TRQs less than 3000 tonnes, or 1% for TRQs greater than or equal to 3000 tonnes.**
- **If any amount of set-aside remains un-distributed to SNE applicants, it will be included in the final allocation process to all non-SNE applicants**

I agree with the Panel's recommendations that provision should be made for small operators and new entrants. Such provisions exist under current AUSFTA quota arrangements and continuation of these provisions is supported.

However, I consider that the level of these provisions should be subject to further discussion with industry with a view to increasing the size of the set-aside and raising the threshold for assistance. The proposed settings are substantially lower than existing arrangements for AUSFTA TRQs, and would do little to encourage exporters building markets.

² The exception to this is US Supplementary TRQs for reasons explained in Recommendation 3(f).

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g. The Panel recommends that FCFS amounts in any TRQ be managed by issuing quota certificates shortly before a planned export of a specified quantity under a specified TRQ should continue.

- **There will be no eligibility or quantity restrictions on the use of quota from any FCFS pool nor will there be a quota ‘reserving’ mechanism.**
- **Quota certificates will be provided by DAFF in the order requests are received.**
- **If an export shipment does not proceed after issuing a certificate, the certificate will automatically lapse usually within a week.**

I agree with this recommendation and the Panel’s rationale that this is the most efficient and effective way of managing an FCFS quota pool.

2. Eligibility and access

a. The Panel recommends that eligibility for TRQ allocations continue to be restricted to dairy manufacturers, and that exporters or traders that do not own and manufacture dairy products should continue to be excluded. However, the Panel recognises the evolution of business structures, and recommends that the definition of ‘manufacturer’ in the Regulations be expanded to include persons/groups who undertake sub-contract processing through a plant they do not own.

I agree with this recommendation.

It would be relatively complex and costly to identify exporters simply for the purpose of quota allocation. Although meat quotas are allocated to exporters, meat exporters can be identified because they are all required to be licensed. This is not the case in the dairy industry where only manufacturing establishments (rather than exporters) need to be licensed.

Export data, sourced from the AQIS EXDOC database, is currently used as the basis for calculating quota entitlements. This data records the manufacturer of the exports and therefore quota allocations are currently made to manufacturers. Although the data also includes names of exporters, the exporter field does not differentiate between the different roles played by exporters. In those cases where the manufacturer is not the exporter, the exporters either act as agents for the manufacturing company (they are freight forwarders or shipping agents) or are trading companies that have purchased the product from a manufacturer for onward sale.

The costs of building an allocation system that can account for the ownership of individual shipments is not justified by the possible benefits, particularly since most exports are undertaken by the manufacturer and other exporters will continue to have access to quota through First Come First Served (FCFS) pools and transfers from manufacturers.

b. The Panel recommends that there should be no restrictions on the transfer or sale of allocated quota or access to a First Come First Served (FCFS) pool.

I agree with this recommendation. It is the most efficient way to facilitate redistribution of TRQs. There are currently no restrictions on the transfer or sale of allocated quota or access to FCFS pools.

3. Implementation and variations to the model

In developing the management model, the Panel has identified a need for some variations where particular features of a TRQ granted to Australia restrict the application of the full model.

a. The Panel recommends that the TRQ management model should be fully applied to all the EU TRQs.

I agree with this recommendation. As discussed in Section 1, representatives from the Department of Agriculture, Fisheries and Forestry will consult with industry on the detail of the model, in particular whether TRQs should be partially allocated to applicants when demand is too low to trigger full allocation of the TRQ.

b. The panel recommends that the TRQ management model should be applied to all AUSFTA TRQs, with the only exception that there be no SNE provision for the small Skim Milk Powder TRQ.

I agree with this recommendation. I consider that introducing SNE provisions for a TRQ as small as the US Skim Milk Powder TRQ of 109 tonnes may fragment the TRQ into commercially unviable ‘parcels’ of TRQ.

c. The Panel recommends that historical USA cheese TRQs cease to be managed by Australia. Historical TRQ is best operated as an unallocated FCFS system managed solely by the USA with no intervention by the Australian Government. This would not reduce ability of USA importers to source product from any Australian supplier.

I agree with this recommendation, noting that the management of these TRQs is the responsibility of USA authorities and that the rights to use these quotas are issued by USA authorities to USA importers. It is not possible for the Australian Government to effectively manage the historical TRQs.

The recommendation to cease management of USA historical cheese TRQs is consistent with other USA historical TRQs such as Skim Milk Powder that have never been managed by Australia.

d. The Panel recommends that USA supplementary cheese TRQs should always be allocated notwithstanding demand.

I agree with the Panel’s recommendation.

In managing the Supplementary TRQs, the Australian Government must nominate the US importers (who will ultimately purchase the product in the quota) before the start of each quota year. The Australian Government has no commercially sensible way of establishing a list of US importers without first obtaining advice from the exporters that will use the

quota. Therefore the quota must be initially allocated to exporters (with any residual operating as an FCFS pool, with the quota in such a pool tied to specific US importers).

e. The Panel recommends that there should be a minimum allocation of 10 tonnes for USA supplementary cheese TRQs.

I agree with this recommendation. Very small FCFS quantities tagged to a single importer are especially unappealing to a potential alternative exporter when the original exporter returns quota or attempts to transfer quota. It is highly unlikely that very small quantities of cheese quota (that can only be sold to a single nominated importer) will be taken up by an alternative TRQ exporter. I agree with the Panel that the greater number of small parcels of individually tagged quota, the greater the potential risk of eroding the value of these particular TRQs.

f. The Panel suggests the Australian Government seek to negotiate changes in the particular importing conditions imposed by the USA for USA supplementary cheese TRQs.

I accept that the problems identified by the Panel with management of US Supplementary quotas can only be resolved by seeking to change US import conditions from notification of importers in advance of the quota year to notification on demand.

I will investigate an appropriate forum to raise this matter with USA authorities.

g. The Panel recommends that the current separation of Other Dairy Products (ODP) into two sub-categories should cease.

I agree that ODP should no longer be managed as two sub-categories. This was a provision put in place in 2005 so that non-dairy manufacturers would have the opportunity to access a potential market for products containing dairy and chocolate (eg. chocolate coated macadamias). The sub-category reserved for these products has not been used since 2005. I consider that the zero utilisation rate for this sub-category no longer supports the rationale for splitting the category.

The Panel was silent on the similar separation of the category Milk/Cream/Ice cream into subcategories of Milk/Cream and Ice cream. This separation has applied since 2005 so that ice cream manufacturers (many of whom were not dairy manufacturers) could access ice cream quota on a FCFS basis while the Cream sub-category could be allocated to dairy manufacturers. The very low usage rates of both sub-categories suggest that there may no longer be a rationale for splitting the category. I will consult with industry on this matter.

h. The Panel recommends that the TRQ management model be implemented from the 2009 quota shipping year. The review has been intensive and stakeholders would reasonably anticipate timely outcomes.

I intend to implement the new model in time for the 2010 quota shipping year, noting that this will provide industry with a transition year to prepare for the new arrangements.

4. TRQ administration

a. The Panel considers it is both appropriate and necessary that DAFF continue to manage TRQ distribution, usage monitoring, availability certification and reporting.

I agree with this recommendation.

b. The Panel recommends that ongoing costs of dairy TRQ administration continue to be recovered from users of all aspects of this service.

I agree with this recommendation.

c. The Panel recommends that the cost recovery framework include continuation of a per kilogram charge for quota; an initial application fee for each TRQ for each applicant (suggested at \$200) to apply whether the TRQ is eventually allocated or not; no refunds for unused quota; and, no charge for quota transfer, or for issue of certifications.

I agree with these recommendations.

d. The Panel notes that the administration system must have the flexibility to adjust unit fees on an annual basis to enable cost-recovery and recommends that DAFF prepare and distribute a short Annual Statement to industry in October before each quota year, showing

- finalisation of income and outgoings for the previous quota year**
- income and outgoings for the current year including estimates for the final months and**
- calculations of projected total costs for the next year and income from applications and allocations.**

The annual statement would form the basis for adjustments to fees after consultation with industry. The Panel suggests the Dairy Australia Trade Reference Group as an appropriate forum for discussion of the Annual Statement and regular administration issues.

I agree with the recommendation for preparation of annual financial statements and consultation with industry before the calculation of appropriate fees for the following quota year.

5. The panel recommends implementing the Panel's recommendations mainly through Orders rather than Regulations which should facilitate adjusting fees.

The initial implementation of the Panel's recommendations will be achieved through amendments to the Dairy Produce Regulations 1986. I will further consider the recommendation to create appropriate Orders for use in the future management of dairy export quotas in Australia.