

Australian Dairy Industry

Submission To Negotiations For An Australia China Free Trade Agreement

17 June 2005

Background

China is one of the world's fastest growing and largest markets for dairy products. Since 1997 there has been an average growth in the volume of imported dairy products of 18% per year. Since 1997 the volume of dairy imports has more than doubled to exceed 370,000 tonnes of dairy products by 2004. After the US, EU, Japan and Mexico, China is now the world's fifth largest dairy import market.

The Australian dairy industry is already sharing in this growth. By 2002, Australia accounted for 20% of China's dairy imports. Although the share has fallen in recent years as a result of bad seasons in Australia, the industry continues to be a major supplier to the market.

With a return to normal seasonal conditions, the Australian dairy industry will be well placed to take advantage of the growth in China's imports of dairy products. Moreover, as the Chinese dairy consumer becomes more sophisticated, the Australian dairy industry expects to supply an increasing volume of higher value added dairy ingredients and high value food service and consumer dairy goods.

In addition to the trade in dairy products, Australia is also a major supplier of dairy cattle to China. 2004 was an extraordinary year with exports exceeding 100,000 animals. While, the numbers are unlikely to be as high in coming years, this is an area of considerable potential with annual exports exceeding 50,000 cattle being a real possibility when the trade settles down.

Australian Dairy Industry Request

Based on the above, it is imperative, therefore, that Australian suppliers of both live cattle and manufactured dairy products are supported by favourable trade policy settings. The industry requires policy settings which will not only provide advantages for the Australian dairy industry but which also ensure that our industry is not disadvantaged relative to our competitors as they negotiate revised terms of trade with China.

In particular, the Australian dairy industry considers that any Free Trade Agreement between Australia and China should include the following elements:

1. Immediate removal of all tariffs on all dairy product lines (in HSCC chapters 04, 17, 18, 19, 21 and 35) and live cattle (falling under HSCC tariff subheading 0102). If this is not feasible, a maximum of three years should be allowed to phase the tariffs to zero
 - 1.1. So long as tariffs and other duties continue we require an understanding on the implementation of customs valuation and on customs procedures.
2. There should be no special treatment for particular dairy products
3. No special safe guards or quotas should apply to any dairy lines
4. Removal of the 24.3% tariff on dairy cattle imports
 - 4.1. In the interim, formal recognition of the Australian Dairy Herd Improvement Certificate in respect of dairy cattle pedigrees as sufficient for the breeder cattle duty waiver.
5. Steps be taken for Chinese authorities to formally recognize regulatory environment for semen and embryos and the quality assurance programs in place at Australian artificial breeding centres
6. An undertaking that Australia will have no worse treatment for dairy imports than is negotiated between China and any other country (particularly New Zealand)
7. An understanding on the use of anti-dumping and countervailing safe guards
8. Specific and detailed harmonization provisions on dairy food standards, SPS, animal welfare and residue levels for food imports
9. Other provisions of importance to dairy:
 - 9.1. Formal recognition of the Australian dairy industry's food safety system including AQIS competence in certifying dairy exports
 - 9.2. Chinese recognition of the Australian vector line for blue tongue
 - 9.3. Removal of the requirement for a Chinese veterinary officer to be present during semen collection
 - 9.4. Standard rules of origin for dairy products
 - 9.5. An understanding on the limits of Geographical Indications as they apply to dairy products.
 - 9.6. A time-table for achieving on-line customs administration and financial settlements
 - 9.7. Investment guarantees (including establishment rights, arbitration and dispute settlement, including investor-state procedures)
 - 9.8. Secure, nation-wide rights for wholly-owned foreign firms to market and distribute goods
 - 9.9. Agreement on IP protection for Australian food technology.

The Australian dairy industry considers that conclusion of an FTA with China would deliver substantial returns to the Australian dairy industry. Moreover, as our competitors move forward with negotiations we are concerned that if we lag behind them in achieving free trade with China we could be facing a loss of a similar amount.

We urge the Australian Government to move forward to conclude the negotiations as quickly as possible.

The Australian dairy industry is of the view that free trade in dairy products would present no threat to the dairy industries of either China or Australia. Indeed it offers opportunities for both parties. As such the Australian dairy industry submits that full free trade in dairy products including dairy cattle should be achievable within a very short time frame with no exceptions.

As has been the case in the negotiation of other Free Trade Agreements in recent years, the Australian dairy industry looks forward to working closely with the Department of Foreign Affairs and Trade at all stages of the negotiation and we stand ready to provide input and advice as is required.

1. Export of Dairy Products to China

1.1. Overview Of Recent Trends In Bilateral Trade

In 2004 China imported 370,234 tonnes of dairy products valued at \$US677 million (approx \$A890 million). Australia supplied about 10 per cent of this product.

The value of Australian exports of dairy products to China grew from just \$A2 million in 1993 to \$A118 million in 2002. However, this was reduced to just \$A70 million in 2004 as a result of prolonged drought.

Recent work commissioned for Dairy Australia estimates that the Chinese market for imported dairy products will continue to grow by 5% (for products such as condensed milk) to 15% (for items such as cheese) per year for the next 10 years. There is, therefore, considerable potential for Australian exporters to take advantage of this market growth.

A more detailed overview of recent trends in the bilateral dairy product trade is at Attachment 1.

1.2. Tariffs

China's accession to the WTO saw the removal of all quantitative restrictions on dairy trade and considerable reductions in tariffs on all dairy lines. Today most dairy products enter China on payment of tariffs of less than 15%. The exception is ice cream which has a bound tariff rate of 19%.

The Chinese tariffs applying to dairy imports are the rates negotiated as part of China's WTO accession package. China's applied rates for dairy are those required by WTO accession agreements. By 2006 the phase in period will be complete and the bound rates will be the rates that apply.

One of the Dairy industry's objectives is to eliminate the remaining tariffs on dairy products. Although none of the bound tariffs are prohibitive, they are sufficient to suppress demand in this very price sensitive market. This is evidenced by the strong

growth in consumption of dairy products when tariffs were reduced following WTO accession. Further tariff reductions are likely to see a similar increase in demand.

As such the removal of these tariffs would see a direct benefit to dairy product exporters through higher returns (as at least part of the cost of the tariff is retained in export prices) and increased volumes (as demand responds to lower prices).

In seeking the removal of dairy tariffs, particular attention will need to be taken to ensure that finished products such as yogurt (0403.1), processed cheese (0406.3) and ice cream (2105) are not the subject of slower tariff removal. Given the rate of growth of China's dairy manufacturing industry there would be no justification for this kind of tariff escalation should it be proposed.

While immediate removal of all tariffs on dairy products would be the preferred outcome, China may prefer a phase in period. In this regard it should be noted that the tariffs have been phasing down since China's accession to the WTO in 2001. A continuation of the current rate of reduction would see all dairy tariffs reduced to zero within three years.

It should be noted that milk production in China is expanding at the rate of 20% per year. This has continued, indeed accelerated, even after accession to the WTO saw dairy tariffs reduced by at least half in most cases. Moreover Chinese dairy farming growth has continued even while the tariffs have been brought down to the bound rates. This suggests that China's dairy farmers do not need tariff protection to ensure their survival. On the contrary, the availability of high quality foreign product has not only helped grow the overall dairy market but has also been an impetus to improved quality of local milk which is increasingly competitive (on both cost and quality terms) against imported product. There should be no reason, therefore, to countenance any suggestion of a need for special safeguards or quotas on dairy items to protect local dairy farmers.

Attachment 2 provides a more detailed analysis of the reasons a Free Trade Agreement with Australia would pose no threat to Chinese dairy farmers.

1.3. Non Tariff Barriers To Trade

WTO accession saw a centralisation of Chinese dairy import licensing requirements for dairy products. This led to some uncertainties during the initial period as authority was moved from the provinces to Beijing. It has, however, resulted in a more transparent national system which currently operates reasonably well.

Increased sophistication, wealth and awareness of contaminated food incidents have heightened Chinese regulation of food products. This has manifested itself in more stringent inspection, increased assurances required at a commercial level and new food safety regulations.

China is implementing a number of food standards for specific dairy products and other associated areas such as food labelling. The process for development and implementation of these standards has generally been cooperative with good consultation with the Australian Government. This has resulted in standards which

are usually in line with international practice. There are, however, some exceptions to this.

For example:

- The current draft storage standard for butter if applied would effectively prohibit the import of butter other than in frozen form.
- The pre-market labelling approval requirements, if applied fully, would also make imports of retail food products virtually impossible.

It is important that Australian authorities keep close contact with Chinese authorities on these issues to ensure that Chinese requirements are transparent in the sense of the WTO provisions on SPS and TBT transparency (notified, published), in keeping with existing international standards and proportionate to the assessed risks. On those occasions where regulations and other requirements are unreasonable we need a fast track mechanism to get them changed to suit commercial reality.

With the increase in regulation of food, through compositional labelling and food safety requirements, there is a danger that regulations could be tightened for political purposes – for example to reduce the competitiveness of imports and so support local industries. Health inspection for liquid milk and cream, for example, has occasionally resulted in difficulties for exporters. While these problems have generally been resolved satisfactorily in the past it is an area of risk to the trade.

To facilitate swift resolution of quarantine and food safety related problems it would be helpful to establish formal recognition by the Chinese authorities of the effectiveness of Australia's dairy food safety system. This includes farm, factory, State and Commonwealth regulations and ultimately AQIS certification for exports of dairy products to China. This could be recognized in the form of a MOU between the two countries associated with the FTA.

Exporters to China report problems with the Chinese customs valuation method. In many cases Chinese Customs do not accept the declared value but instead assign values based on Chinese Customs' estimation of the market value of the product. This often leads to the levying of higher tariffs than would usually be the case.

It would be useful if the FTA could include an agreement on Customs valuation to overcome problems with overvaluation of imports for the purpose of import tariffs. In the first instance valuation should be on the basis of declared value. Where Customs authorities have reason to doubt the truth of declared values, alternate values should only be assigned following consultation with the Australian Government and the industry affected. Any such agreement would need to include provisions to ensure that product is not held up while negotiations take place. An option could be the payment of provisional duties to clear product while the actual value is determined.

1.4. Impact Of The Removal And/Or Reduction Of Barriers To Trade

2002 Australian dairy exports to China would have attracted tariffs at WTO bound rates of approximately \$A12 million (actual tariff levied was a little higher as some tariff rates were still phasing down to final WTO bound levels). With the removal of

these tariffs it is reasonable to expect that some of this would be retained by Australian exporters in the form of higher returns. If half of this is retained, the value to the Australian dairy industry would be \$A6 million per annum.

In addition the increase in demand for Australian products at the preferential tariff rate would see an increase in trade in these products. If this saw a doubling in the volume of trade then increased returns to Australian exporters (from tariffs not paid on the increased trade) would be an additional \$A6 million per annum bringing the value of the tariff cuts to a total \$A12 million per annum.

If, on the other hand, our largest competitor New Zealand negotiated an FTA and Australia did not, we would have to discount our exports by some \$12 million to keep our market share or suffer loss of market share to avoid arbitrage of lower prices into other markets.

None of the above takes account of savings from improved customs valuation and smoother quarantine operations. In addition anticipated growth in cheese and other dairy segments when realized should see a considerable increase in the above estimates. It is estimated that this would be worth at least \$A3 million per annum.

As such an FTA with China would be worth at least \$A15 million per annum initially and considerably more as the market develops. Given the huge potential for growth in this market the industry anticipates that actual returns from an FTA would be considerably greater than this.

2. Export of Dairy Cattle Genetics to China

2.1. Overview Of Recent Trends In Bilateral Trade

According to the Australian Bureau of Statistics, exports in 2004 reached 100,000 animals worth \$A214 million. While the numbers in future years are likely to be closer to the 50,000 mark, this is a significant market that needs to be considered in the context of an FTA with China.

The Australian Dairy Herd Improvement Scheme (ADHIS) produces breeding values on Australian and international dairy cattle and this objectively shows that Australia has some of the best dairy cattle genetics (semen and embryos) in the world. While trade with China in this kind of genetic material is relatively light, there is enormous capacity to grow this business via Australian artificial breeding centres.

In addition, Australian dairy genetics expertise and herd improvement expertise can be a growth industry for trade with China.

2.2. Existing Barriers To Trade And Other Issues For A FTA

There are three significant barriers to this trade:

- . the requirement for 3 generation pedigree for breeding cattle
- . the vector line for blue tongue
- . the Chinese requirement for a Chinese veterinarian to be present during semen collections.

Dairy cattle imported into China may be imported under two categories. Dairy cows for general purposes attract a tariff of 24.3% while cattle imported for breeding purposes are duty free. All cattle imported into China are imported for the benefit of the Chinese dairy industry and as such the impediment of a 24.3% tariff should be removed immediately.

The Chinese Government is of the view, however, that rather than relying on commercial forces to ensure high quality, it is appropriate to provide a special incentive to import higher quality animals for breeding purposes. These cattle receive a duty waiver. The Australian dairy industry is currently negotiating with the Chinese Government for recognition of a scheme currently being developed by the Australian Dairy Herd Improvement Scheme to provide pedigree information on cattle exported to China. Ultimately, formal recognition by the Chinese authorities of this assurance as being sufficient for duty waiver and any other special concessions is sought.

It is anticipated, however, that the full implementation of the scheme will take a number of years. It has been requested that in the interim the Chinese authorities accept the hybrid assurance that is currently being negotiated. It would be useful if the FTA negotiators could use the negotiations as a catalyst to encouraging the Chinese to accept the system currently being offered to them as an interim measure until there are sufficient cattle with full three generation pedigrees registered for sale to China. This interim measure is necessary as it will take a number of years before sufficient fully registered and certified three generation pedigree cattle can be produced to meet China's requirements.

Currently China does not recognize the Australian controlled vector line for blue tongue. This effectively means that most cattle from States north of Victoria are ineligible for trade. Recognition of this zone by China would allow export from many NSW dairy areas. Within Australia the animal health quarantine and movement of animals regulations are governed by rigorous state laws with significant infrastructure to ensure their integrity. For example there are a large number of State Government veterinarians constantly monitoring animal health and there are severe penalties for breaching regulations relating to the movement of cattle. This is not well recognized by the Chinese Government.

The requirement that Chinese veterinarians be present for semen collection is costly and would be unnecessary if the Chinese recognized Australian artificial breeding (AB) centres' quality assurance systems and Australia's regulatory environment for the management of AB centres as well as semen and embryo collection and processing. The Australian dairy industry requests that formal procedures be put in place for the recognition of Australian AB centres.

As with the trade in products it is important that Australian authorities keep close contact with Chinese authorities on quarantine issues to ensure that Chinese requirements are transparent in the sense of the WTO provisions on SPS and TBT transparency (notified, published), in keeping with existing international standards and proportionate to the assessed risks. On those occasions where regulations and other requirements are unreasonable we need a fast track mechanism to get them changed to suit commercial reality.

2.3. Impact Of The Removal And/Or Reduction Of Barriers To Trade

The trade in live dairy cattle, embryos and semen has developed very rapidly in recent years. It has, however, been opportunistic rather than strategic. The dairy industry would like to change this situation and develop long term trading relationships based on recognition of Australia's quality assurance, quarantine and regulatory environment. While it is probable that the recent growth in the live animal trade may slow in coming years, there is enormous opportunity to grow trade in semen and embryos. Formal recognition of Australia's regulatory environment and quality assurance systems would facilitate longer term business partnerships between Australian and Chinese companies.

3. Regional Considerations

In recent discussions with the Department of Foreign Affairs and Trade it has been suggested that should full free trade not be immediately achievable nationally, there may be some scope for accelerated liberalisations for particular regions.

The dairy industry does not believe that such a regional approach is necessary for the liberalisation of trade in dairy products or dairy cattle as there is a strong argument for the immediate removal of all trade barriers. At the same time there is no justification from a protectionist perspective for the maintenance of any of the existing barriers.

We are concerned that, given the nationwide nature of China's dairy market, any special arrangements for specific regions would be difficult to manage and as such could introduce unwelcome complexities into the commercial environment. However, if a regional approach is adopted priority might be given to accelerated elimination of barriers to entry to those parts of China with the highest consumption of dairy products or the largest capability for manufacture of dairy products.

Attachment 3 is provided as a guide to the most probable priorities.

Recent Trends In Australian Exports Of Dairy Products To China

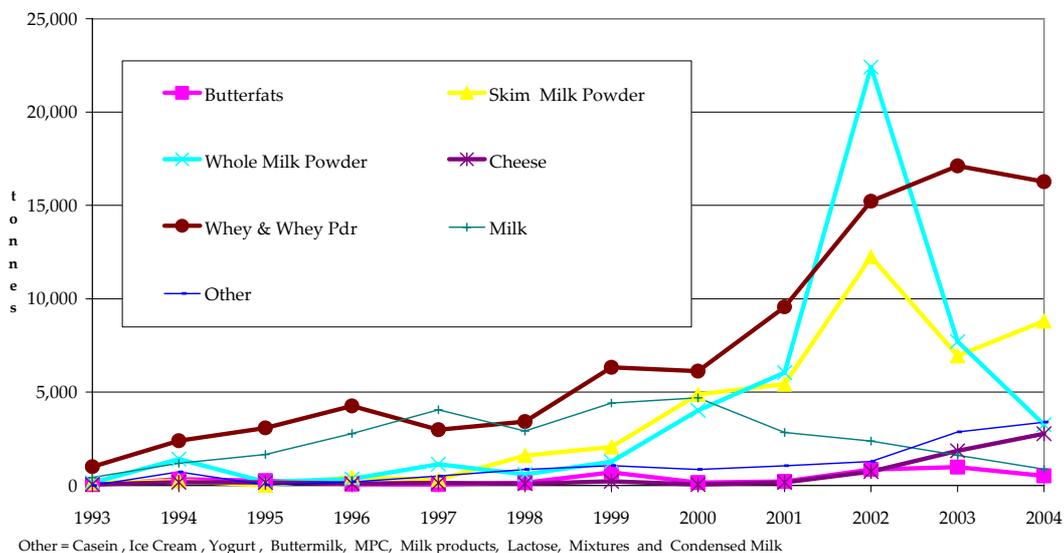
In 2004 China imported 370,234 tonnes of dairy products valued at \$US677 million (approx \$A890 million). Australia supplied about 10 per cent of this product.

The value of Australian exports of dairy products to China grew from just \$A2 million in 1993 to \$A118 million in 2002. However, this was reduced to just \$A70 million in 2004 as a result of prolonged drought.

As the following graph shows, most of the trade to date has been in whey powder, skim milk powder and whole milk powder. With the reduction in milk availability in 2003 and 2004, Australian national production of skim and whole milk powder has been cut back considerably. This has seen the surge in exports in 2002 cut back to the previous growth line.

Although shortages of supply have reduced Australian sales, demand for milk powders in China continues to grow with increasing requirements for the rapidly expanding food processing sector and increasing requirements for high quality milk powders for child food and infant formula.

Australian Dairy Exports to China



Whey powder, on the other hand, as a bi-product of more profitable cheese production has continued to be manufactured in increasing quantities and Australian exporters have been able to take advantage of this growing market. Although it is expected that growth in this segment will continue, it is probable that current applications for whey powder will be replaced with other more specialized milk powders as incomes rise and consumers become increasingly sophisticated. This trend may, however, be reversed if the relative price of skim and whole milk powder continues to increase compared to the cheaper whey powder available from the US and EU.

Exports of liquid milk exceeded 4,000 tonnes per annum between 1997 and 2000. This too has fallen away a little in recent years as demand for liquid milk has increasingly been met by local fresh milk or recombined milk made from imported SMP and butter oil. In addition, liquid milk imports have been the subject of particularly tight quarantine inspections which has made this trade difficult.

The Chinese cheese market is still at a very early stage of development. Although some ethnic groups have traditionally consumed sheep and goats cheese, cheese made from cows milk is still new to the market. Most older Chinese still find the taste and smell of cheese offensive. Consumption of cows' cheese is currently estimated to be 5,000 to 10,000 tonnes per annum. This is mostly made up of imported mozzarella cheese for pizzas, cheese for processing or processed cheese (primarily consumed on hamburgers). The remainder is sold direct to consumers (mostly as processed cheese slices) or to the food processing or food service industries.

Previous experience in other North Asian countries (Japan, Korea, Taiwan and Hong Kong) suggests that Chinese cheese consumption will grow in line with increased disposable income and westernization of the diet.

A study of the China dairy market undertaken for Dairy Australia by Stanton, Emms and Sia in March 2004 estimates that the Chinese market for imported dairy products will continue to grow by 5% (for products such as condensed milk) to 15% (for items such as cheese) per year for the next 10 years. There is, therefore, considerable potential for Australian exporters to take advantage of this market growth – particularly if the returns in China are improved due to lower tariffs and higher consumer sophistication.

The Australia – China Dairy Industry Relationship. Is Australia a Threat?

The Australian dairy industry does not represent any threat to the Chinese dairy industry. This would not change even with complete free trade between the two countries. Indeed imports from Australia complement local dairy products.

Australia supplies the Chinese dairy sector at all incidents along the value added chain.

Australia is able to provide animal feed, embryos, semen, live breeding cows and replacement cows as well as dairy farming technology and equipment. As the major supplier of dairy cows to China, Australian dairy farmers have a strong interest in seeing continued growth in the Chinese dairy farming sector.

Milk production in China has grown by an average of 18% per year over the past 7 years and is forecast to grow at a rate of at least 10% per annum for the next 7 years.

The Australian dairy industry does not see support for milk production in China as being in conflict with the objective of growing Australian sales of dairy products to China. While production of milk in China is growing at the rate of around 10 to 20% per year, imports continue to grow at about the same rate. There is still a lot of room for growth in the Chinese dairy market with room for increased sales from both domestic milk and imported dairy products alike.

In particular, locally produced milk tends to be targeted at the fresh drinking milk and other fresh products sectors whereas Australia supplies dairy ingredients or higher value added products for direct consumption.

The main customers for Australian dairy products in China are the large Chinese dairy companies. These are the same companies which are the main users of locally produced milk. In this respect, the imported ingredients from Australia support the profitability of these companies and so enhance their ability to expand and to buy more locally produced milk.

Australia also provides new and innovative dairy ingredients to local manufacturers of pharmaceuticals, nutraceuticals, infant formula and a broad variety of food products. Again the supply of these high quality products from Australia complements rather than competes with the product made from local milk.

When looking at any possible threat to China from the Australian dairy industry the relative sizes of our two industries must also be considered. Milk available from Australia to make dairy products for export to China will only ever make up a small proportion of Chinese demand for dairy products.

In the 2003/04 season Australia produced 10.1 billion litres of milk – down from a peak of 11.3 billion litres in 2001/02 prior to the recent poor seasons. It is projected that, even given a return to good seasons in Australia, milk production will not again

achieve sustainable growth of 2-3% per annum until at least 2006/07. Half of Australian production is sold on the domestic market which leaves about 5 billion litres for export to over 100 countries – including a number of well established and very valuable markets such as Japan, the Philippines, the US and the EU. As such, even with complete free trade with China, the amount of milk available for export to China will be limited. Even if China reached the position of our second largest export market, it would still only account for about 10% of Australian dairy exports – which is only 0.5 billion litres in milk equivalent terms.

Stable high international prices could boost production in Australia above these levels. One factor that could generate this would be the forecast surge in consumption of cheese in China. If this occurs, a larger volume of Australian milk could enter China. This would, however, be in the form of cheese at a prevailing high world price. As such it would not pose any threat to local producers.

China's milk production in 2004 was estimated to have been 20 billion litres which was almost double Australia's production in that year. All of this milk was consumed locally, together with 370,000 tonnes of imported product which is roughly equal to about 2 billion litres on a milk equivalent basis. In other words, China consumed dairy products equal to about 22 billion litres of milk in 2004.

If 10% of Australia's dairy exports were sent to China in 2004, this would have accounted for just 2% of Chinese milk consumption. Given that dairy product consumption in China is growing at the rate of 15% per year for most products, it is unlikely that imports from Australia would have had any impact on the demand for locally produced milk.

It has, however, been argued that even this small proportion could impact on the market if Australian dairy products are significantly cheaper than those made in China. This argument is lost on the fact that Chinese farm gate prices are in fact lower than those paid in Australia.

The Australian farm gate price for milk is set according to various quality and seasonal factors but is ultimately limited by the price attainable for dairy products on the international market. On this basis, the average current price for Australian milk at the farm gate is approximately \$US20 per 100 kg of milk.

China has a similarly unregulated system of pricing with different prices paid according to quality, location and the end use of the milk. However, in 2004 the mean price for milk in Northern China was 1.5 RMB / litre which is \$US18 per 100 kg of milk. This is 10% **LESS** than the average farm gate milk price in Australia.

Moreover product exported from Australia must be transformed into exportable product and then shipped to China. These costs ensure that Australian product entering China will not be in direct price competition with local milk. This has been particularly so in recent years as the Australian industry has moved away from the production and export of commodities. Today, Australia's dairy exports are high quality, value added products in the form of specialized ingredients and targeted food service or consumer products. These products attract higher prices as they are offered for sale on the basis of value rather than price.

History has demonstrated that the Chinese dairy farming sector can flourish without protection from imports. Prior to accession to the WTO most dairy products entering China attracted tariffs of around 50%. On accession these were all reduced to less than 20% and since then have been phased down to just 10 to 15%. While these tariff reductions occurred, Chinese domestic milk production grew at the rate of around 18% per annum. This growth has not been halted as tariffs have come down. Clearly the remaining tariffs are not necessary to protect local producers and as such could be removed immediately with no ill effect.

In short free trade in dairy products from Australia can not be seen as any threat to Chinese dairy farmers because:

- . at most Australia would only be able to supply about 2% of dairy product demand in China – any increase would be more than accounted for by Chinese consumption growth
- . the farm gate price in Australia is on average 10% higher than the usual price in Northern China
- . Australian milk incurs transformation and shipping costs before it is available in China
- . changes to Australian manufacturing focus in recent years means that Australia no longer devotes most of its exportable production to commodities but instead focuses on higher value products
- . historical experience has shown that China's dairy farmers have flourished in the face of steeper tariff reductions than a move from current levels to zero would require.

Not only does Australia pose no threat to Chinese dairy farmers, imports of dairy products from Australia in fact already complement local production. The Australian dairy industry's biggest customers in China are the large dairy companies such as Shanghai Bright, Yili and Mengniu which are also the primary users of local milk. Ingredients from Australia support the operations of these large companies enabling them to stay profitable and sustain higher returns to their farmer suppliers.

Regional Priorities

In recent discussions with the Department of Foreign Affairs and Trade it has been suggested that should full free trade not be immediately achievable nationally, there may be some scope for accelerated liberalisations for particular regions.

The dairy industry does not believe that such a regional approach is necessary for the liberalisation of trade in dairy products or dairy cattle as there is a strong argument for the immediate removal of all trade barriers. At the same time there is no justification from a protectionist perspective for the maintenance of any of the existing barriers.

However, if a regional approach is finally adopted the following is provided as a guide to the most probable priorities.

Dairy Products

In the short to medium term, the main customers for Australian dairy products will be the wealthier consumers in the larger cities and the large Chinese dairy companies.

In this regard, the initial focus for consumer products should be on those provinces which exhibited per capita expenditure on dairy products by urban residents in 2004 well above the national average of 132 RMB/person.

Specifically these provinces and cities would be:

	Per Capita Consumption of dairy products in 2004 (RMB per person)
Beijing	255.79
Shanghai	250.03
Chongqing	183.91
Fujian	161.33
Shandong	159.16
Jiangsu	144.22
Zhejiang	143.51
Shanxi	143.35
Liaoning	138.18
Anhui	137.02
Tianjin	135.49

Although Tibet is the highest with expenditure on dairy nearly four times the national average, the small population and difficult logistics would suggest that Tibet would not be a priority.

The special economic zones at the Pearl River Delta would also be worthy of consideration. Even though dairy consumption in the province of Guangdong is well below the national average, consumption in its major cities of Shenzhen (234RMB/person) and Guangzhou (198RMB/person) are relatively high.

Ingredients are more difficult to focus regionally as they are largely consumed by the large dairy companies. These companies have their bases in the large cities (especially Beijing and Shanghai) or in the dairy farming provinces in the North and West but have manufacturing operations all over the country. In targeting these companies, the provinces with the largest dairy product output are the most likely candidates.

These are:

	2004 Dairy Product Output ('000 tonnes)
Heilongjiang	393
Shaanxi	138
Inner Mongolia	138
Beijing	137
Hebei	114
Shandong	110

In addition the provinces around the large cities of Shanghai, Beijing, Tianjin and Guangzhou are priorities for dairy ingredient suppliers.

For dairy cattle the main focus would be on the provinces which are increasing the size of their dairy herds, notably Inner Mongolia, Heilongjiang, Shandong and Sichuan as well as the provinces around the large cities of Shanghai and Beijing.