

EXPLANATORY STATEMENT

Select Legislative Instrument 2009 No. 252

Issued by Authority of the Minister for Agriculture, Fisheries and Forestry

Dairy Produce Act 1986
Dairy Produce Amendment Regulations 2009 (No. 1)

Section 126 of the *Dairy Produce Act 1986* (the Act) provides, in part, that the Governor-General may make regulations, not inconsistent with the Act, prescribing all matters required or permitted by the Act to be prescribed, or necessary or convenient to be prescribed for carrying out or giving effect to the Act.

Section 52 of the Act provides that the regulations may declare that specified dairy produce is regulated dairy produce and specified dairy markets are regulated dairy markets in respect of that produce. Section 53 of the Act provides for prohibitions on certain exports of regulated dairy produce to regulated dairy markets. Section 54 of the Act allows for regulations to prescribe conditions relating to approvals to export regulated dairy produce to regulated dairy markets.

The *Dairy Produce Amendment Regulations 2009 (No. 1)* (the Amendment Regulations) enable the implementation of a new model for the allocation of export tariff rate quotas (TRQ) for certain dairy products to the European Union (EU) and the United States of America (US).

The TRQs, which were negotiated in several forums between 1979 and 2005, allow Australia to export specific quantities of particular dairy products to the EU and US at reduced (or nil) tariff rates. The Department of Agriculture, Fisheries and Forestry (DAFF) has been responsible for managing these dairy TRQs on behalf of the Australian dairy industry since July 2003.

In 2008, the Minister for Agriculture, Fisheries and Forestry established an independent panel to review arrangements for all dairy TRQ managed by Australia. As a result, a simpler and more flexible model for allocating quotas has been developed. The model is more likely to optimise the value of the TRQs to Australia.

The Amendment Regulations introduce this new model, which is based on an annual application process that is open to all dairy manufacturers. Each applicant will receive the volume of TRQ requested, unless there is insufficient TRQ to meet demand. In this case, each applicant will receive a share of the available quota proportional to the amount of the TRQ product they have exported over the previous three years, compared to all other applicants' exports of that product over the same period. Any TRQ that is still available after the annual allocation process will be made available on an unrestricted first-come-first-served basis, either as an allocation or casually. The new model also provides for an amount of quota to be set-aside specifically for small and new entrants.

The Amendment Regulations also introduce a \$200 application fee for each dairy TRQ category applied for, in addition to the current volume based fee charged on quota accessed. The new fee is designed to discourage frivolous or vexatious applications, thereby moderating administration costs. Administration of the TRQs is undertaken by DAFF on a fully cost-recovered basis. The revenue from the volume based charge is expected to decline under the new allocation method, however, this will be offset by the increased revenue from the application fee. The administration costs are not expected to rise as a result of the introduction of the new allocation methodology.

The model reduces barriers to export. It also simplifies quota management by replacing four distinct sets of rules on access and usage of quota with a single, consistent set of rules, with minimal exceptions.

Consultation

In formulating its recommendations, the dairy quota review panel consulted widely with all sectors of the dairy industry and with relevant government authorities. The panel's chair also delivered presentations on the panel's recommendations to two government-industry meetings held on 20 August and 14 October 2008 in Melbourne. Attendees at these two meetings included dairy TRQ users as well as representatives of the Australian Dairy Industry Council and the Australian Dairy Products Federation who have since expressed broad support for adopting the recommendations. An industry-government working group was also established to resolve the technical details of the new model recommended by the panel providing industry with additional opportunities for consultation and comment on the new model and the Amendment Regulations.

The Office of Best Practice Regulation was consulted prior to the preparation of the Amendment Regulations. A Regulation Impact Statement (RIS) is attached, as an Annex (OBPR reference number 9907). The Department of Foreign Affairs and Trade endorsed the RIS as meeting its information requirements for a Trade Impact Statement. A Cost Recovery Impact Statement on the new proposed fee structure was also prepared by the department and was endorsed by the Department of Finance and Deregulation as fulfilling the reporting requirements of the government's cost recovery policy.

Details of the Amendment Regulations are set out in the Attachment. The Amendment Regulations are a legislative instrument for the purpose of the *Legislative Instruments Act 2003*.

The Amendment Regulations will commence on the day after they are registered on the Federal Register of Legislative Instruments.

Authority: Section 126 of the Dairy Produce Act 1986

Details of the Dairy Produce Amendment Regulations 2009 (No. 1)

Regulation 1 – Name of Regulations

This regulation provides that the title of the Regulations is the *Dairy Produce Amendment Regulations 2009 (No. 1)* (the Amendment Regulations).

Regulation 2 – Commencement

This regulation provides that these Regulations commence on the day after they are registered on the Federal Register of Legislative Instruments.

Regulation 3 – Amendment of Dairy Produce Regulations 1986

This regulation provides that Schedule 1 amends the *Dairy Produce Regulations 1986* (the Principal Regulations) as set out in the Schedule.

Regulation 4 – Application

This regulation establishes transitional arrangements so that the amendments made by Schedule 1 do not apply in relation to:

- (a) quota and entitlement to export allocated for 2009; or
- (b) consignments of regulated dairy produce that are to be imported into a regulated dairy market in 2009.

This ensures that the Amendment Regulations do not apply to quota that was allocated under the Principal Regulations.

Schedule 1- Amendments

Item [1] – Part 2

This item provides that Part 2 of the Principal Regulations, which sets out the existing method for distributing the dairy tariff rate quotas managed by Australia, is replaced by the new Part 2 in Schedule 1. This new Part sets out a completely new model for allocating dairy quotas for the same products to the same markets as provided for in the Principal Regulations (the only exception being those TRQ categories which are for Historical US WTO quota products – under the new model, quota for these products will no longer be managed by Australia).

Part 2 provides conditions relating to the control of exports of regulated dairy produce to regulated dairy markets.

Part 2, Division 2.1 provides general conditions relating to the export of regulated dairy produce to regulated dairy markets.

Regulation 2.01 provides for the interpretation of terminology used in Part 2.

Regulation 2.02 provides that the object of Part 2 is to establish a system of export controls for the export of regulated dairy produce to regulated dairy markets. This

facilitates the orderly export of regulated dairy produce in respect of that produce and enables the Commonwealth to administer Australia's volumetric entitlements to access particular markets at reduced, or special, tariff rates.

Regulation 2.03 provides that the European Union (EU) is declared a regulated dairy market in respect of regulated dairy produce described in Part 2 of Schedule 1A. This Regulation ensures that TRQ to the EU of the products listed in Part 2 of Schedule 1A can be effectively administered by DAFF. This market is cited in the Principal Regulations.

Regulation 2.04 provides that the United States of America (US) is declared a regulated dairy market in respect of regulated dairy produce described in Part 3 or 4 of Schedule 1A. This Regulation ensures that quota exports to the US of the products listed in Part 3 or 4 of Schedule 1A can be effectively administered by DAFF. This market is cited in the Principal Regulations.

Regulation 2.05 provides a list of the categories of dairy produce that are regulated by Part 2. These are the same categories currently cited in the Principal Regulations.

Regulation 2.06 provides that, in reference to the US Australia-United States Free Trade Agreement dairy produce category of *Creams and Ice Cream*, a reference to the 'weight of dairy produce' is to be read as referring to 'volume of dairy produce'; a reference to 'kilograms' is to be read as referring to 'litres'; a reference to an 'amount per kilogram' is to be read as referring to an 'amount per litre' and a reference to 'tonnes' is to be read as referring to 'kilolitres'.

Regulation 2.07 provides that a fee is payable on the quantity of quota accessed. The fee amount is at subregulation 2.13(2) and is 0.7 of a cent per kilogram (\$7.00 per tonne). This is the same fee as cited in the Principal Regulations.

Subregulation 2.07(1) provides that this regulation applies if a provision in this part sets a fee that is expressed as an amount per kilogram of quota (the fee rate).

Subregulation 2.07(2) provides that the per kilogram fee that is payable is calculated by multiplying the fee rate by the number of kilograms of quota. This is rounded to the nearest cent, with 0.5 of a cent rounded up.

Part 2, Division 2.2 provides conditions relating to annual quota allocations.

Regulation 2.08 provides conditions relating to applications for annual quota allocations.

Subregulation 2.08(1) provides that a dairy manufacturer may apply to the Secretary of DAFF for an allocation of annual quota for a calendar year in relation to a particular category of dairy produce.

Subregulation 2.08(2) provides that an application for an allocation of quota in relation to a US WTO category must be received by the Secretary:

- (a) for 2010 – no later than 16 October 2009; and

- (b) for a later year – no later than 1 October in the previous year.

The above deadlines ensure that sufficient time is available to undertake annual allocations each year and to provide the US authorities with a list of nominated US importers and the volumes of quota to be attributed to each of the nominated importers each year. Nb. Under US requirements, an amount of US WTO quota that is not attached to importers in this way is unusable during the following year.

Subregulation 2.08(3) provides that an application for an allocation of quota in relation to an EU category or US FTA category must be received by the Secretary:

- (a) for 2010 – no later than 23 October 2009; and
- (b) for a later year – no later than 12 October in the previous year.

This ensures that sufficient time is available to undertake annual allocations each year.

Subregulation 2.08(4) provides that the application must in a form approved by the Secretary, and be accompanied by an application fee of \$200. It also provides that the application contain specified information. The specified information is required to enable DAFF to administer the quotas.

Subregulation 2.08(5) provides that applications for US WTO categories must be for a minimum volume of 10 tonnes. This is because of the US imposed condition that all US WTO quota must be tied to a specific US importer, and smaller quantities of quota may not be effectively used by Australian exporters. The minimum amount avoids fragmentation of the quota and allows for better commercial utilization.

Subregulation 2.08(6) provides that an application is not valid if the required information listed in subregulations 2.08 (4) and (5) are not provided.

Regulation 2.09 provides that the Secretary may ask applicants for further information about their activities to verify whether they are an entity that is eligible to receive an allocation. Eligibility for annual quota allocations is restricted to dairy manufacturers - as per the Principal Regulations - and manufacturers that undertake subcontract processing through equipment or a facility that they do not own. This removes a barrier to entry for processors that do not own their own facility.

Subregulation 2.09(1) provides that for the purpose of verifying that an applicant is either a dairy manufacturer, or has made a valid application, the Secretary may ask the applicant to provide further information.

Subregulation 2.09(2) provides that a request for further information must:

- (a) be made in writing; and
- (b) identify the information required; and
- (c) state the date by which the applicant must give the information to the Secretary.

Subregulation 2.09(3) provides that the date stated for subregulation 2.09(2)(c) above must not be earlier than 7 days after the date of the request. This is to provide a reasonable timeframe for the applicant to prepare its response.

Subregulation 2.09(4) provides that despite subregulation 2.08 (6), the applicant is taken not to have made a valid application unless:

- (a) the applicant gives the Secretary the required information by the date stated in the request; and
- (b) the application then meets the requirements in subregulations 2.08 (4) and (5).

Regulation 2.10 provides the conditions under which the Secretary may make annual quota allocations.

Subregulation 2.10(1) provides that if the Secretary makes a request/s for information under regulation 2.09 about one or more applications for annual quota in relation to a category of dairy produce, the Secretary may only allocate quota for that category after the due dates for all the requests have passed and the closing date for applications under regulation 2.08 has passed. This is to allow affected applicants time to provide further information prior to the allocations being determined.

Subregulation 2.10(2) provides that if the Secretary does not request information about any of the applications in relation to a category of dairy produce, the Secretary may only allocate quota for that category after the closing date for applications. This is to ensure all applications have been received before quota allocations are made.

Subregulation 2.10(3) provides that if the total quota applied for in all valid applications for a category is less than or equal to the total available quota, then the Secretary must allocate each applicant the amount of quota applied for. This is because there is no need to ration quota when there is sufficient quota available to meet each applicant's request.

Subregulation 2.10(4) provides that if the total quota applied for in all valid applications for a category is more than the total available quota, then the Secretary must allocate each applicant an amount of quota according to regulation 2.11.

Subregulation 2.10(5) provides that this regulation does not require the Secretary to allocate quota to a particular applicant, or to any applicant, if the Secretary considers that it would not be in the best interests of the dairy industry to make the allocation. A similar provision exists in the Principal Regulations.

Subregulation 2.10(6) provides that if the Secretary does not allocate quota to an applicant because of subregulation 2.10 (5), the Secretary must, within 7 days after making the decision:

- (a) give to the applicant a written notice that sets out the reasons for the decision; and
- (b) include a statement advising that, if the applicant is dissatisfied with the Secretary's decision, the applicant may apply to the Administrative Appeals Tribunal for review of the decision.

This allows any applicant who is not granted quota due to a decision made by the Secretary the opportunity to appeal the decision.

Regulation 2.11 provides for a new method to determine allocations of quota in circumstances where the sum of all valid applicants' requests for annual quota

allocations in a given dairy quota product category exceeds the volume of quota available in that product category.

The detailed method for the model for annual allocations is outlined in regulation 2.11 and subregulations 2.11(1), 2.11(2), and 2.11(3). A summary of the key features of the new methodology follows:

Annual Allocations

- 1 If the aggregate amount of TRQ requested from all applicants exceeds the amount of TRQ in a TRQ category, then a 2% Small and New Entrant (SNE) set-aside amount will be subtracted from the total volume of that TRQ category and the remaining amount (“available TRQ”) will be used for calculating all applicants’ pro-rata share of the allocation.
- 2 A pro-rata share of the “available TRQ” amount will be calculated for each applicant. Each applicant’s pro-rata share of the “available TRQ” is based on a three year moving average of the applicant’s exports of the product category covered by the TRQ, compared to all other applicants.
 - 2.1 Average export performance will be calculated from the three financial years immediately preceding the year in which allocations are being made.
 - 2.2 An equal weighting will be applied to global exports and exports to the TRQ market.
 - 2.3 Global exports will include shipments to the TRQ market.
- 3 SNEs with no export performance will be required to provide documentary evidence that they meet the eligibility requirements (i.e. that they are a dairy manufacturer or that they transform or manufacture dairy products through a plant that they do not own) to receive TRQ allocations.
- 4 The formula for determining allocations is set out in Figure 1 below:

Equation 1: Allocated TRQ

$$\text{Applicant A's share} = \left(\frac{\text{Applicant A's TRQ market exports}}{\text{All applicants' TRQ market exports}} + \frac{\text{Applicant A's global exports in TRQ type products}}{\text{All applicants' global exports in TRQ type products}} \right) / 2$$

Notes: Each applicant’s share is 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 type products as a proportion of all applicants’ global exports in those TRQ type products. The values used in these calculations will use average exports over the preceding three years.

Example:

Applicant A’s share of the total TRQ for the AUSFTA cheddar cheese TRQ 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 (say 90,000 kilograms) as a

proportion of all applicants' exports of cheddar cheese to the US over the same period (say 100,000 kilograms), and Applicant A's global exports of cheddar cheese over the previous three years (say 100,000 kilograms) as a proportion of all applicants' global exports of cheddar cheese over the same period (say 1,000,000 kilograms). An equal weighting would be given to exports to the US and global exports;

or

$$\text{Applicant A's share} = \left(\frac{90,000 \text{ kg}}{100,000 \text{ kg}} + \frac{100,000 \text{ kg}}{1,000,000 \text{ kg}} \right) / 2 = 0.5$$

Applicant A's share (0.5) is then multiplied by the amount of quota available (869,000 kg) to determine their allocation;

or

$$0.5 \times 869,000 \text{ kg} = 434,500 \text{ kilograms}$$

- 5 The TRQ amount requested on the application form for a particular TRQ will be the maximum quantity of that TRQ an applicant can be offered through the annual allocation process.
 - 5.1 If the applicant is an eligible SNE (see below), the maximum quantity of TRQ will be either the amount requested OR the SNE threshold amount, whichever is lower.
 - 5.2 If amounts of TRQ are subsequently available via a first-come-first-served (FCFS) pool, any entity will be able to access that TRQ, regardless of quantity applied for or quantity received via the annual application process.

SNE Provisions

- 6 If the volume of a TRQ allocation calculated for an eligible entity under the above process is less than 60 tonnes it will be classed as an SNE and will be eligible for additional quota.
- 7 SNEs receive a performance based allocation as outlined above, and in addition are eligible to receive an equal share of TRQ from an amount that is set-aside specifically for SNEs.
- 8 The size of the set-aside for each allocated TRQ will be 2% of the total quota amount, with the exception of AUSFTA skim milk powder TRQ for which there will be no SNE provisions. The set-aside will only operate if:
 - 8.1 the aggregate of all requested amounts for a particular TRQ is greater than the amount of TRQ available for that year; and
 - 8.2 one or more eligible applicants would receive an allocation of less than 60 tonnes from the pro-rata share calculation of the available TRQ.
- 9 The formula for SNE allocations is set out in Figure 2 below.

Equation 2: SNE Allocations

$$\text{Applicant A's allocation} = \text{Applicant A's pro rata allocation} + \frac{\text{SNE set aside}}{\text{number of eligible SNEs}}$$

Note: All applicants' shares of a given TRQ will be calculated as per Equation 1 above. Following this calculation, any applicant whose pro-rata share is less than 60 tonnes will be eligible to receive an equal share of an SNE set-aside amount in addition to a performance-based share.

- 10 Final SNE allocations will be no higher than 60 tonnes or the quantity requested.
- 11 If, after the SNE set-aside amount has been shared equally amongst all eligible SNEs, there is a set-aside amount remaining (ie. because one or more SNE's allocation has reached 60 tonnes and/or the amount requested) then the remaining set-aside amount will be shared equally among the remaining eligible SNEs - this process will be repeated until there is no set aside amount remaining or until each SNE applicant has received the amount requested or 60 tonnes.
- 12 If there is a surplus amount of any SNE set-aside pool remaining after all SNEs have received their maximum allocations, then the surplus amount will be distributed to all non-SNE applicants together with their annual allocation amounts.

If there are no eligible SNEs, the calculation set out in Equation 1 will be re-run using the total quantity of the TRQ category for that year.

Regulation 2.12 provides that the Secretary must give written notifications of allocations to applicants. This regulation ensures applicants are aware of their quota entitlement and how much they are required to pay to access it.

Subregulation 2.12(1) provides that if annual quota is allocated to a dairy manufacturer under regulation 2.10, that the Secretary must give the dairy manufacturer a written notice of the allocation as soon as practicable.

Subregulation 2.12(2) provides that the notice must include:

- (a) the category of dairy produce to which the quota relates; and
- (b) the amount of quota allocated; and
- (c) the fee that the dairy manufacturer must pay under regulation 2.13; and
- (d) the due date for payment of the fee; and
- (e) the conditions to which the allocation is subject.

Regulation 2.13 provides that fees are payable for allocated annual quota. The fee is 0.7 of a cent per kilogram fee as cited in the Principal Regulations.

Subregulation 2.13(1) provides that if a dairy manufacturer is allocated annual quota under regulation 2.10, the dairy manufacturer must pay a fee for the exclusive right to use that quota in relation to consignments.

Subregulation 2.13(2) provides that the fee for each kilogram of quota is 0.7 of a cent. It also notes that for the *US FTA Creams and Ice Cream* category, the fee is 0.7 of a cent per litre of quota — see regulation 2.06.

Subregulation 2.13(3) provides that the fee must be paid by the due date specified in the notice issued by the Secretary under subregulation 2.12 (1).

Subregulation 2.13(4) provides that if all or part of the fee is not paid by the due date, the Secretary must withdraw so much of the applicant's allocated quota as has not been paid for. This regulation is to ensure that apparently unwanted quota can be made available to interested parties. All revenue will contribute to covering the costs to DAFF of providing the quota administration service.

Subregulation 2.13(5) provides that the applicant may voluntarily return all or part of the allocated quota under regulation 2.17 before the due date. This regulation encourages quota mobility.

Subregulation 2.13(6) provides that the applicant may not transfer quota under regulation 2.18 if the fee for that amount of quota has not been paid. It also notes that allocated quota will not be able to be used in relation to consignments under Division 2.5 (Export approvals) until the fee has been paid. This regulation ensures that quota holders pay before being able to use or transfer quota. All revenue will contribute to covering the costs to DAFF of providing the quota administration service.

Regulation 2.14 provides the conditions for the refund of application fees. This regulation ensures that applicants are treated reasonably and fairly.

Subregulation 2.14(1) provides that if an applicant pays the application fee under paragraph 2.08 (4) (c), but is not allocated any annual quota under regulation 2.10, the Secretary must refund the application fee. It also notes that this provision applies whether or not the application was valid.

Subregulation 2.14(2) provides that the fee is not refundable if the quota is allocated and later withdrawn or voluntarily returned. This is to reflect the fact that there are fixed costs associated with processing applications and administering the quotas.

Regulation 2.15 provides that the allocation of annual quota is subject to the following conditions:

- (a) the quota holder must, within 14 days after a significant change occurs, tell the Secretary in writing of the change;
- (b) any other condition the Secretary considers appropriate.

This regulation enables the Secretary to assess whether changes in a quota holder's circumstances affect their ability to use their quota. The Secretary can then withdraw such quota as deemed necessary, thus ensuring that quota that may otherwise be unusable remains mobile.

Part 2, Division 2.3 provides conditions relating to return, loss or transfer of annual quota allocations. This is to encourage quota mobility.

Regulation 2.16 provides that the Secretary must withdraw any amount of unattached annual quota for a calendar year if the quota holder does not tell the Secretary, in writing, on or before 15 June in that year, how the quota holder intends to deal with the unattached quota (unattached quota is that which has not already been attached to a specific export consignment). It also notes that before 5 June each year, the Secretary will send a notice about the requirement in this regulation to each quota holder. This regulation is designed to focus quota holders on their intentions and to ensure that quota that would otherwise be unused would be available to be taken up by other interested parties. The Secretary's notice is designed to ensure quota holders have the opportunity to respond to DAFF with intended usage details, so as not to inadvertently lose quota through the automatic withdrawal process.

Regulation 2.17 provides conditions for the voluntary return of quota.

Subregulation 2.17(1) provides that at any time on or before the end of a calendar year, a holder of annual quota for the year may notify the Secretary in writing that the holder wishes to return an amount of unattached quota. This regulation is designed to promote mobility of quota, as returned quota would become available to other interested parties.

Subregulation 2.17(2) provides that the Secretary must withdraw the amount of quota from the holder's allocation. It also notes that if the Secretary is notified of a return of quota after 15 June, the quota will be counted in determining a penalty under regulation 2.19.

Regulation 2.18 provides conditions for the transfer of annually allocated quota. The ability to transfer quota without restrictions is the same as transfer provisions in the Principal Regulations. Although there are no restrictions on quota holders transferring their annual allocations, any penalties for unused transferred annual quota will remain with the transferor unless the transferee is also an eligible manufacturer and therefore subject to receive any applicable penalty through the annual allocation process. This is to ensure quota holders do not transfer quota at the last minute just to avoid penalties.

Subregulation 2.18(1) provides that a holder of unattached annual quota for a calendar year may transfer some, or all, of the quota to another person. This will facilitate efficient use of the quotas.

Subregulation 2.18(2) provides that it is not a transfer of quota if a quota holder authorises an agent to export dairy produce on behalf of the holder.

Subregulation 2.18(3) provides that for a transfer to be validly made, a notice to the Secretary must be made which includes:

- (a) the name of the transferor and the transferee;
- (b) the category of dairy produce;
- (c) the amount of quota being transferred; and

- (d) whether the transferee is a dairy manufacturer or not.

It also notes that if the transferee is not a dairy manufacturer, and the transferred quota is unused at the end of the calendar year, then the transferred quota will still be counted against the transferor in determining a penalty under regulation 2.19.

Subregulation 2.18(4) provides that if the Secretary receives a valid notice under subregulation 2.18(3), the Secretary must:

- (a) withdraw the transferred amount from the transferor's annual quota;
and
- (b) allocate that amount to the transferee.

This enables DAFF to provide quota certificates to transferees.

Subregulation 2.18(5) provides that annual quota that is transferred under this regulation is subject to the same conditions that applied to the quota before it was transferred. This helps maximise the overall value of the TRQs to Australia.

Regulation 2.19 provides conditions for the imposition of penalties on future allocations of a particular TRQ product if annual quota remains unused at the end of the calendar year. The introduction of penalties for unused quota is completely new as there are no similar penalty provisions in the Principal Regulations. The purpose of the new penalty provisions is to focus exporters on their intentions, and encourage the early return of unwanted quota, thereby promoting quota mobility and maximising the overall value of the TRQs to Australia.

Subregulation 2.19(1) provides that in this regulation *surplus quota*, in relation to a dairy manufacturer, means the sum of any unused annual quota for a calendar year that the dairy manufacturer holds as at the end of 31 December; any annual quota for a calendar year that the dairy manufacturer returned under regulation 2.17 after 15 June; and any unused annual quota for a calendar year which was transferred to a transferee who was not a dairy manufacturer. This calculation is used to determine whether a quota holder has used sufficient of their allocated annual quota so as not to incur a penalty on their next allocation of that TRQ.

Subregulation 2.19(2) provides that for Subregulation 2.19(1)(c), if unused quota is held by a transferee who is not a dairy manufacturer (and is therefore not subject to penalties), that amount of unused quota is to be divided between all dairy manufacturers who transferred quota to that transferee (according to the proportional amounts transferred by each). This will enable an accurate and fair attribution of unused quota to eligible dairy manufacturers, to be used in calculating each manufacturer's surplus quota amount.

Subregulation 2.19(3) provides that a penalty be imposed on a dairy manufacturer in relation to a category of dairy produce if the surplus amount of unused quota is more than 2% of the total quota to which the dairy manufacturer had access (through the annual allocation process or from receiving a transfer of quota) for the smaller volume TRQs (ie. those with a total available amount of less than 3000 tonnes).

Subregulation 2.19(4) provides that a penalty be imposed on a dairy manufacturer in relation to a category of dairy produce if the surplus amount of unused quota is more than 1% of the total quota to which the dairy manufacturer had access (through the annual allocation process or from receiving a transfer of quota) for the larger volume TRQs (ie. those with a total available amount of 3000 tonnes or more).

Subregulation 2.19(5) provides that the amount of the penalty imposed is equal to the surplus quota.

Subregulation 2.19(6) provides that a penalty imposed on a dairy manufacturer by this regulation applies to the next allocation of annual quota to the dairy manufacturer under regulation 2.10.

It also notes that because a penalty is imposed at the end of a calendar year (ie. after allocations have been made for the following year), the penalty will relate to quota that is for use the year after next at the earliest. For example, surplus quota remaining at the end of 2010 will result in a penalty applying to the allocation of quota for use in 2012 at the earliest. If no quota is allocated to the dairy manufacturer for 2012, the penalty would apply to the allocation for 2013, and so on, for five years.

Subregulation 2.19(7) provides that the penalty expires after the dairy manufacturer has been allocated annual quota under subregulations 2.10 (3) or (4). It also provides that if no allocation is made to a dairy manufacturer with an outstanding penalty in the following 5 years, the penalty will expire.

It notes that if a category is not allocated in any particular year (ie. because the total of all valid applications is less than or equal to the total available quota) any outstanding penalties will expire.

It also notes that a penalty imposed because of surplus quota in 2010 will expire at the end of 2015. This will occur if the dairy manufacturer has not received any allocations for the years 2012 to 2016 inclusive.

Part 2, Division 2.4 provides conditions for the allocation of first-come-first-served (FCFS) quota. Applications for first-come-first-served quota will be processed strictly in the order received. FCFS is the most efficient way to manage low demand TRQ categories. It provides unrestricted access to any entity able to export the TRQ product.

Regulation 2.20 provides conditions that will apply to applications for FCFS quota.

Subregulation 2.20(1) provides that a person may apply to the Secretary, in writing, for an allocation of FCFS quota in a category of dairy produce for which some quota is still available after the annual allocation has been made. This regulation ensures flexible access to the quota.

Subregulation 2.20(2) provides that an application for FCFS quota in relation to a particular calendar year may be made on or after 1 November in the previous year. This ensures that applications for FCFS quota are not made until after the available FCFS quota amounts are known (ie. after the annual allocation process has been completed).

Subregulation 2.20(3) provides that the application must be in a form approved by the Secretary, and be accompanied by an application fee of \$200. It also provides that the application contain specified information. The specified information is required to enable DAFF to administer the quotas.

Subregulation 2.20(4) provides that if more than one date is advised in the application (under subparagraph (3) (b) (v)), the applicant must indicate how much of the quota applied for is intended to be attached to each consignment on each date.

Regulation 2.21 provides the conditions the Secretary must observe in allocating 'unallocated' or FCFS quota.

Subregulation 2.21(1) provides that the Secretary must deal with applications made under regulation 2.20 strictly on a first-come-first-served basis. This is to ensure fair and consistent treatment of all applications.

Subregulation 2.21(2) provides that if the amount of unallocated quota in relation to a category of dairy produce is greater than or equal to the amount of FCFS quota applied for, the Secretary must allocate to the applicant the amount of quota applied for. This regulation eliminates unnecessary discretion.

Subregulation 2.21(3) provides that if the amount of unallocated quota in relation to a category of dairy produce is less than the amount of FCFS quota applied for, the Secretary may either allocate the unallocated quota to the applicant, or notify the applicant to determine if they would like to receive a lesser amount. This subregulation also provides for a refund of the application fee if the applicant did not wish to receive a lesser amount of quota. This regulation ensures that applicants are treated reasonably and fairly.

Subregulation 2.21(4) provides that if there is no unallocated quota available in relation to the category of dairy produce applied for, the Secretary must notify the applicant and refund the application fee. This regulation ensures that applicants are treated reasonably and fairly.

Subregulation 2.21(5) provides that this regulation does not require the Secretary to allocate quota to an applicant if the Secretary considers that it would not be in the best interests of the dairy industry to make the allocation. This is the same as the Principal Regulations and is designed to protect the dairy industry and DAFF administration against unusual events.

Subregulation 2.21(6) provides that if the Secretary does not allocate quota to an applicant because of subregulation 2.21(5), the Secretary must give the applicant a written notice that sets out the reasons for the decision within 7 days after making the decision, including advice that the applicant could seek a review of the decision through the Administrative Appeals Tribunal. This subregulation also provides that a refund of the application fee will be made if the Secretary does not allocate quota to an applicant because of subregulation 2.21(5). It also notes that regulation 2.41 contains further information concerning the review of decisions. This regulation ensures that applicants are treated reasonably and are made aware of their rights of appeal against adverse decisions.

Regulation 2.22 provides that notifications of allocations are to be provided to the applicant.

Subregulation 2.22(1) provides that if FCFS quota is allocated to a person under regulation 2.21, the Secretary must give the person a written notice of the allocation.

Subregulation 2.22(2) provides that the notice of allocation must include detail on the category and amount of dairy produce, the fee payable, and the conditions to which the allocation is subject.

Regulation 2.23 provides that a fee of 0.7 of a cent per kilogram is payable for allocated FCFS quota. This is the same fee that is cited in the Principal Regulations.

Subregulation 2.23(1) provides that if a person is allocated FCFS quota under regulation 2.21, the person must pay a fee for the exclusive right to use that quota in relation to consignments. This is similar to provisions relating to access and use of 'unallocated' (FCFS) quota in the Principal Regulations.

Subregulation 2.23(2) provides that the fee for each kilogram of quota is 0.7 of a cent. It also notes that for the *US FTA Creams and Ice Cream* category, the fee is 0.7 of a cent per litre of quota — see regulation 2.06. This fee is the same as the fee cited in the Principal Regulations.

Regulation 2.24 provides that holders of FCFS quota allocations must, within 14 days after a significant change occurs, tell the Secretary in writing of the change. This subregulation also provides for any other condition the Secretary considers appropriate to be imposed. See Regulation 2.15.

Regulation 2.25 provides that the Secretary must withdraw an amount of FCFS quota allocated under regulation 2.21 once it is clear it has not been used. This regulation ensures that unused FCFS quota is returned as soon as possible so that it can be made available to others.

Part 2, Division 2.5 provides conditions for export approvals.

Part 2, Division 2.5, Subdivision 2.5.1 provides conditions for exports of regulated dairy produce to the European Union.

Regulation 2.26 provides definitions for terminology used in Subdivision 2.5.1.

Regulation 2.27 provides conditions for applications for approval to export produce in a European Union dairy quota category.

Subregulation 2.27(1) provides that before a consignment of produce in an EU category is exported, the exporter of the produce must obtain an approval from the Secretary to export the consignment. Similar provisions exist in the Principal Regulations.

Subregulation 2.27(2) provides that an application for approval to export a consignment must be made in a manner approved by the Secretary.

Subregulation 2.27(3) provides that an application for approval to export a consignment in a particular year may be made on or after 1 November in the previous

year. This ensures that steps to access quota are not made until after the annual allocation process has been completed.

Regulation 2.28 provides conditions for the grant of approval to export to the European Union.

Subregulation 2.28(1) provides that the Secretary must grant an approval to export a consignment of regulated dairy produce if:

- (a) an application is made by the exporter under regulation 2.28; and
- (b) either:
 - (i) the exporter's available quota for the relevant category of dairy produce is equal to or greater than the shipped weight of the consignment; or
 - (ii) the unallocated quota available for the relevant category of dairy produce is equal to or greater than the shipped weight of the consignment, and the exporter has paid the fee set out in subregulation (2) to attach quota to the consignment; and
- (c) the Secretary has no reason to believe that the total shipped weight of eligible produce that, under the law of the European Union, may be imported into the European Union from Australia will be exceeded as a result of the export.

Subregulation 2.28(2) provides that for subparagraph (1) (b) (ii), the fee is 0.7 of a cent per kilogram of consignment quota.

Regulation 2.29 provides that notices of approval to export are to be provided to the exporter.

Subregulation 2.29(1) provides that if the Secretary grants an approval to export, the Secretary must give the exporter a written notice of approval that sets out the shipped weight of regulated dairy produce that may be exported in the consignment, the day the approval takes effect and the conditions to which the approval is subject. Similar provisions exist in the Principal Regulations.

Subregulation 2.29(2) provides that an approval to export is not transferable. It also notes that under subsection 53 (1) of the Act, a person is guilty of an offence if the person exports regulated dairy produce to a regulated dairy market and the person does not hold an approval in relation to that export.

Regulation 2.30 provides conditions of approval to export.

Subregulation 2.30(1) provides that an approval to export is subject to the following conditions:

- (a) the exporter must obtain an IMA 1 certificate (which is a document used by the European Union to monitor quota use and a requirement of quota access) for the consignment before the consignment is accepted for entry into the European Union;
- (b) the exporter must notify the Secretary in writing if it becomes likely that the consignment will not be accepted for entry into the European Union;

- (c) any other condition that the Secretary considers appropriate.

Subregulation 2.31(2) provides that if the shipped weight of produce in the consignment is less than the shipped weight stated in the notice of approval under regulation 2.29, the exporter will be taken to have exported the latter weight unless the exporter tells the Secretary in writing, within 28 days after the produce is loaded for shipment, the actual shipped weight. Similar provisions exist in the Principal Regulations.

It also notes that under subsection 53 (2) of the Act, a person that holds an approval in relation to an export of regulated dairy produce to a regulated dairy market is guilty of an offence if the export is not in accordance with the conditions of the approval.

Regulation 2.31 provides the conditions relating to the period of approval to export to the European Union.

Subregulation 2.31(1) provides that an approval to export a consignment takes effect on the date specified for that purpose in the notice of approval given under subregulation 2.29 (1).

Subregulation 2.31(2) provides that an approval to export a consignment ceases to have effect:

- (a) if an IMA 1 certificate is not obtained for the consignment within 28 days after the day the approval takes effect; or
- (b) if paragraph (a) does not apply — on the earlier of:
 - (i) 3 months after the day the approval takes effect; and
 - (ii) 31 December in the year for which the approval of export was granted.

This is the same as in the Principal Regulations.

Regulation 2.32 provides conditions for the surrender of approval to export.

Subregulation 2.32(1) provides that the holder of an approval to export may surrender the approval at any time by giving notice in writing to the Secretary.

Subregulation 2.32(2) provides that when the approval is surrendered, the approval ceases to have effect.

Part 2, Division 2.5, Subdivision 2.5.2 provides conditions for exports of regulated dairy produce to the United States.

Regulation 2.33 provides definitions for terminology used in Subdivision 2.5.2.

Regulation 2.34 provides conditions for approval to export.

Subregulation 2.34(1) provides that before a consignment of produce in a United States World Trade Organisation category or Australia-United States Free Trade Agreement category is exported, the exporter of the produce must obtain an approval from the Secretary to export the consignment. This is the same as the Principal Regulations.

Subregulation 2.34(2) provides that an application for approval to export a consignment must be made in a manner approved by the Secretary.

Subregulation 2.34(3) provides that an application for approval to export a consignment in a particular year may be made on or after 1 November in the previous year.

Regulation 2.35 provides conditions for the grant of approval to export.

Subregulation 2.35(1) provides that the Secretary must grant an approval to export a consignment of regulated dairy produce if:

- (a) an application is made by the exporter under regulation 2.34; and
- (b) either:
 - (i) the exporter's available quota for the relevant category of dairy produce is equal to or greater than the shipped weight of the consignment; or
 - (ii) the unallocated quota available for the relevant category of dairy produce is equal to or greater than the shipped weight of the consignment, and the exporter has paid the fee set out in subregulation (2) to attach quota to the consignment; and
 - (c) the Secretary has no reason to believe that the total shipped weight of eligible produce that, under the law of the United States of America, may be imported into the United States of America from Australia will be exceeded as a result of the export.

Subregulation 2.35(2) provides that for subparagraph (1) (b) (ii), the fee is 0.7 of a cent per kilogram of consignment quota. It also notes that for the US FTA *Creams and Ice Cream* category, references to 'shipped weight' are to be read as referring to the shipped volume (in litres) and the fee is 0.7 of a cent per litre of quota — see regulation 2.06.

Regulation 2.36 provides conditions for notices of approval to export. Similar provisions exist in the Principal Regulations.

Subregulation 2.36(1) provides that if the Secretary grants an approval to export, the Secretary must give the exporter a written notice of approval that sets out:

- (a) the shipped weight of regulated dairy produce that may be exported in the consignment; and
- (b) the day the approval takes effect; and
- (c) the conditions to which the approval is subject.

Subregulation 2.36(2) provides that an approval to export is not transferable. It also notes that under subsection 53 (1) of the Act, a person is guilty of an offence if the person exports regulated dairy produce to a regulated dairy market and the person does not hold an approval in relation to that export.

Regulation 2.37 provides the conditions of approval to export.

Subregulation 2.37(1) provides that an approval to export is subject to the following conditions:

- (a) the exporter must notify the Secretary in writing if it becomes likely that the consignment will not be accepted for entry into the United States of America;
- (b) any other condition that the Secretary considers appropriate.

Subregulation 2.37(2) provides that if the shipped weight of produce in the consignment is less than the shipped weight stated in the notice of approval under regulation 2.36, the exporter will be taken to have exported the latter weight unless the exporter tells the Secretary in writing, within 28 days after the produce is loaded for shipment, the actual shipped weight. It also notes that under subsection 53 (2) of the Act, a person that holds an approval in relation to an export of regulated dairy produce to a regulated dairy market is guilty of an offence if the export is not in accordance with the conditions of the approval.

Regulation 2.38 provides that an approval to export a consignment:

- (a) takes effect on the date specified for that purpose in the notice of approval given under subregulation 2.36 (1); and
- (b) ceases to have effect on the earlier of:
 - (i) 3 months after the day the approval takes effect; and
 - (ii) the end of 31 December in the year for which the approval of export was granted.

This is the same as the Principal Regulations.

Regulation 2.39 provides conditions for the surrender of approval to export.

Subregulation 2.39(1) provides that the holder of an approval to export may surrender the approval at any time by giving notice in writing to the Secretary.

Subregulation 2.39(2) provides that when the approval is surrendered, the approval ceases to have effect.

Part 2, Division 2.6 provides for miscellaneous conditions.

Regulation 2.40 provides for variation and revocation of an allocation or approval. This regulation allows for flexibility in management of the TRQs and aims to optimise the overall value of the TRQs to Australia.

Subregulation 2.40(1) provides that the Secretary may, at any time, vary or revoke an allocation of quota made or transferred, or an approval to export granted, under this Part if:

- (a) the Secretary is satisfied that the allocation or approval is no longer consistent with the object of this Part; or
- (b) the Secretary considers that it is in the best interests of the dairy industry to make the variation or revocation.

Subregulation 2.40(2) provides that the holder of allocated quota or an approval to export may ask the Secretary, in writing, for a variation to be made to the allocation or approval.

Subregulation 2.40(3) provides that the Secretary may vary an allocation of quota or an approval to export:

- (a) by adding, varying or revoking a condition of the allocation or approval; or
- (b) by varying the period of the allocation or approval.

Subregulation 2.40(4) provides that if the Secretary makes a variation or revocation under this regulation, the Secretary must give the holder of the allocation or approval a written notice of the decision that states:

- (a) the reasons for the decision; and
- (b) the day on which the variation or revocation takes effect; and
- (c) that the person may apply to the Administrative Appeals Tribunal for a review of the decision

Regulation 2.41 provides conditions for the review of decisions made in the course of administering the dairy quotas. It provides that an application may be made to the Administrative Appeals Tribunal for review of a decision:

- (a) to impose a condition, under paragraph 2.15 (b) or 2.24 (b), on an allocation of quota; or
- (b) to impose a condition, under paragraph 2.30 (1) (c) or 2.37 (1) (b), on an approval to export a consignment; or
- (c) not to allocate quota because of subregulation 2.10 (5) or 2.21 (5); or
- (d) to vary or revoke an allocation or approval under regulation 2.40.

Regulation 2.42 provides conditions for the Secretary to delegate powers under Part 2.

Subregulation 2.42(1) provides that the Secretary may, in writing, delegate to an SES employee, or acting SES employee, of DAFF all or any of the Secretary's powers and functions under this Part (except this power of delegation).

Subregulation 2.42(2) provides that in exercising powers or functions under a delegation, the delegate must comply with any directions of the Secretary.

Item [2] Schedule 1B

This item omits Schedule 1B. This regulation reflects a decision to remove a split of the AUSFTA *Other Dairy Products* TRQ category into two sub-categories.

Amendment of Administrative Arrangements for EU and USA Dairy Quotas Managed by Australia

This Regulation Impact Statement (RIS) has been prepared by the Australian Government Department of Agriculture, Fisheries and Forestry (DAFF) to assist the Australian Government to make decisions regarding options to improve the management arrangements for all Australian dairy tariff rate quotas (TRQs) from the European Union (EU) and the United States of America (USA).

The regulations governing these quota arrangements have been in place for a number of years. The government established an independent panel to review these arrangements in April 2008. The *2008 Dairy Quota Review Panel* (the Panel) consulted widely with industry and government agencies and has recommended significant changes to quota management arrangements which would require amendments to the *Dairy Produce Regulations 1986*. The Panel's recommendations are contained in a report which was provided to the Minister for Agriculture, Fisheries and Forestry, the Hon. Tony Burke MP, on 6 June 2008.

The primary conclusion of the RIS is that the broad thrust of the Panel's recommendations, including the adoption of a new TRQ allocation model, is preferable to other TRQ management options and constitutes a more appropriate framework for administering the dairy TRQs than the existing arrangements.

This RIS has been prepared in accordance with *Australian Government Best Practice Regulation Guidelines* issued by the Office of Regulation Review.

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1. Background

Quota arrangements introduced under the Australia-United States Free Trade Agreement (AUSFTA) in 2005 were agreed to on the basis that a formal review of the quota arrangements would be undertaken after three years' operation. On 2 April 2008, the Minister for Agriculture, Fisheries and Forestry, the Hon. Tony Burke MP, announced an independent review of AUSFTA and WTO dairy tariff rate quota (TRQ) management, and released the Terms of Reference. The 2008 Dairy Quota Review Panel was asked to examine arrangements for all dairy TRQs for the EU and the USA managed by Australia, and to identify improvements.

Under the AUSFTA, Australia has tariff-free entry into the US for specified annual quantities of dairy products (i.e. quotas) in 12 broad categories. The access amount of each category increases each year by an agreed percentage between 3-6%. Most of the AUSFTA categories are allocated on a historical basis to Australian dairy manufacturers but two categories are unallocated, also referred to as first-come-first-served. In the 2007 quota year, Australia had total quota access of 30,204 tonnes of dairy product to the US under the AUSFTA.

In addition, Australia has quota access of 7,000 tonnes of cheese to the USA under World Trade Organisation (WTO) agreements. Quota is allocated in two components - by the US Department of Agriculture to US importers based on historical trade; and to USA importers on the basis of advice from Australia. In total, this takes Australia's dairy quota access to the USA, under both AUSFTA and WTO agreements, to 37,204 tonnes for 2007.

Australia also has dairy quota access of 4,211 tonnes to the EU under WTO agreements. This quota covers two products, table cheddar and cheese for processing, and is allocated to Australian exporters based on historical export data.

WTO TRQ management arrangements were put in place by the Australian Dairy Corporation (ADC) and Australian Dairy Industry Council (ADIC) after the General Agreement on Tariffs and Trade (GATT) Tokyo Round of multilateral trade talks (1979) and the WTO Uruguay Round (1994). In 2003, DAFF assumed responsibility for TRQ management.

AUSFTA TRQ Regulations are based on an industry approach negotiated with government in 2004. This included agreement for formal review after three years.

Following extensive consultation with industry and government agencies, the 2008 Dairy Quota Review has finalised its review of all dairy quota administration systems and the Panel has made a series of recommendations to improve these systems ([Attachment](#)).

2. The problem or issues which give rise to the need for action

As discussed above, the current AUSFTA dairy quota arrangements are based on an ADIC proposal negotiated with government in 2004. It included agreement that a formal review would be undertaken after three years operation of the AUSFTA. WTO quota arrangements are based on a system that was put in place by the ADC and ADIC following the GATT Tokyo Round of multilateral trade talks and the WTO Uruguay Round. These arrangements were 'inherited' by DAFF when the ADC was privatised in 2003 and have not been reviewed since that time. Industry accepted they should be reviewed at the same time as AUSFTA quotas.

In April 2008, the government established an independent Panel to review the administrative arrangements for dairy export quotas to the USA and the EU to make sure these arrangements are efficient, fair and cost-effective, and to provide recommendations for any possible improvements. The Panel has reported on the concepts underpinning the quota controls, the quota allocation process and the ongoing administration of the quotas and made a series of recommendations to improve the management of USA and EU TRQs.

The key recommendation is to change the model for allocating dairy TRQs. The Panel argues that the current allocation system locks the bulk of dairy TRQ volumes to particular companies from one year to the next and that this does not maximise the value of the TRQs to Australia.

The Panel raised the following arguments in support of its recommendation for a new model:

- dairy TRQs are a public asset resulting from government to government market access negotiations;
- TRQ management is not intended to create property assets (i.e. permanent allocations of TRQ) for individual companies;
- management of these quotas should be based on public policy principles that can achieve the best outcomes for the dairy industry and the broader Australian community; and that
- these public policy objectives include promoting economic prosperity by increasing the competitiveness of Australian dairy industry and consideration of social, environmental, access and regional issues.

In addition, the Panel noted that successive Australian governments, through the Council of Australian Governments, have reinforced their commitment to comprehensive reform of business regulations. The national reform agenda objectives include removing regulation not providing public benefit, and to:

- accelerate and broaden the regulation reduction agenda;
- improve processes for regulation making and review; and
- deliver significant improvements in Australia's competition, productivity performance and international competitiveness.

3. The desired objective(s)

The government is keen to make sure that management of dairy quotas is fair, cost-effective and efficient. The following five principles were adopted by the Panel to guide its deliberations in evaluating appropriateness, effectiveness and efficiency of current quota management arrangements and options. Quota management arrangements should:

1. Optimise the TRQs commercial value to Australia.
2. Minimise government intervention in the marketplace.
3. Administer consistently, transparently and efficiently.
4. Minimise barriers to exporting.
5. Consider commercial arrangements.

The government considers these principles constitute an appropriate framework for evaluating different options for changing the way that dairy TRQs are managed by Australia and that it is necessary to change the TRQ allocation model to a model that is more closely aligned with these principles.

4. The options (regulatory and/or non-regulatory) that may constitute viable means for achieving the desired objective(s)

The Panel evaluated a number of options for TRQ management utilised in various circumstances, in the context of the above principles, policy directions and industry perspectives. TRQ management options looking forward five years could include:

- 4.1) Continuation of current arrangements, including fixed allocations for all the EU and the main USA TRQs
- 4.2) No quota allocation - 'first-come-first-served'
- 4.3) Combined 'first-come-first-served'/allocation system
- 4.4) Annual allocation of all TRQs
- 4.5) Auction of each TRQ

Option 4.1) Continuation of current arrangements, including fixed allocations for all the EU and the main USA TRQs

4.1.1) EU WTO dairy quotas

Australia has 4,211 tonnes of cheese quota to the EU. Australia's cheese quotas are defined in EC Regulation 2535/2001 and are detailed in Table 1.

Table 1.

EU Quota	Customs Tariff No.	Product	Access Amount	Import Duty
09.4521	0406 90 21	Table Cheddar Cheese	3,711 tonnes	€17.06/100kg
09.4522	0406 90 01	Cheese for Processing	500 tonnes	€17.06/100kg

The in-quota tariff of €170.06 per tonne is significantly less than the out-of-quota tariff of €1,671.00 per tonne. Both these products are classified as bulk products.

4.1.2) EU WTO quota administration

The quotas are managed by DAFF's Quota Administration Unit. A certificate known as an IMA-1 is required by the EU for dairy produce imported into the European regulated dairy market at a reduced tariff rate. The Australian Quarantine and Inspection Service (AQIS) issues the IMA-1 certificates at the request of the Quota Administration Unit for exports within these cheese quotas and is recognised by the EU as the official Australian government issuing authority.

4.1.3) EU WTO quota holders

There are currently seven EU cheese quota holders for bulk table cheddar. There is currently one holder of the EU cheese for processing quota.

4.1.4) EU WTO quota allocation process

Quotas are formally allocated to companies in October each year in time for the shipping year which is the period of 12 months commencing on 1 November in a year and ending on 31 October in the next year.

Australia's cheese tariff quota entitlement for the EU has been constrained, by agreement with industry, to a fixed distribution of entitlement to manufacturers, based on historical export data. Three thousand tonnes of the total 4,211 tonne quota is based on manufacturers' global exports in 1980 and 750 tonnes is allocated according to global exports during 1994. The latest increase of 461 tonnes is calculated as a proportion of all exports to new EU member countries by the specified manufacturer, averaged over 2002 and 2003 with a minimum allocation of one tonne.

Some changes have occurred over time due to amalgamations, closures or permanent transfers of entitlement.

4.1.5) EU WTO usage rules

A manufacturer will only lose quota entitlement in a subsequent year if they have not shipped any quota product in the two previous years. That entitlement will be made available for allocation to any exporter on application to the Secretary of DAFF or for pro-rata distribution to other exporters in subsequent years.

In relation to temporary transfers of quota, in August each year unused quota may be withdrawn from exporters for the remainder of the quota year unless the exporter advises that the quota will be used. This quota may then be distributed by the Secretary of DAFF to other exporters for the remainder of the year.

4.1.6) EU WTO new entrant provisions

New entrants can only obtain quota through a transfer from existing quota holders or from DAFF for quota that has lapsed or been withdrawn under the provisions outlined above.

4.1.7) EU WTO fees

A fee for the approval of quota entitlement is prescribed in the regulations. The fee is designed to provide cost recovery for the management of entitlement to concessional access on an annual basis. The fee is currently set at \$0.007 per kilogram of entitlement approved (\$7.00 per tonne) and is payable in advance.

4.1.8) EU WTO quota usage

The EU cheese quotas have always been well utilised as shown in Table 2.

Table 2.

EU Table Cheddar			EU Cheese for Processing		
Year	Annual Quota (kgs)	Shipped (Kgs)	Year	Annual Quota (kgs)	Shipped (Kgs)
2004	3,250,000	3,249,960	2004	500,000	500,000
2005	3,250,000	3,249,840	2005	500,000	499,820
2006	3,711,000	3,701,000	2006	500,000	495,580
2007	3,711,000	3,704,000	2007	500,000	500,000

4.1.9) US WTO dairy quotas

With the USA, Australia has WTO country quota entitlements for a total of 10,765 tonnes of dairy products as set out in Table 3. The Australian Government only plays a role in managing the quotas for the four cheese categories listed in Table 3, and these management arrangements will be discussed in 4.1.10. The non-cheese categories are managed entirely by the USA and will not be discussed further.

Table 3. WTO DAIRY QUOTAS - USA

PRODUCT	WTO QUOTAS
Condensed Milk	92 mt
NDM or SMP	600 mt
WMP/BMP/Feeds	57 mt
Other Dairy	1016
Chocolate crumb	2000
Cheddar cheese	2,450 mt
American cheese	1,000 mt
Swiss cheese	500 mt
NSPF (other) cheese	3,050 mt
Total	10 765 mt

Australia has access to a total TRQ of 7000 tonnes of cheese. Australia's USA WTO quota rights were granted in two separate trade negotiations: 4,000 tonnes in 1980 under the GATT Tokyo Round agreement and 3,000 tonnes in 1995 under the WTO Uruguay Round agreement. Following the commencement of the AUSFTA in 2005, the tariffs on all of these quota cheeses (which ranged from 10% to 20%) reduced to zero.

Out-of-quota tariffs on the TRQ-type cheeses remain at prohibitively high levels ranging from US\$1055 per tonne to US\$1877 per tonne.

4.1.10) Quota allocation and management mechanisms in the USA

It is important to discuss the arrangements within the USA for the management of Australia's country cheese quotas since this largely affects the capacity of the Australian Government to manage the same quotas.

The United States Department of Agriculture (USDA) allocates Australia's WTO country quota rights to licensed USA importers. The USDA publishes the names of these importers annually on its website. Australian exporters can only sell WTO quota product to these licensed importers.

As an additional complication, the import licences are issued for either *historical* or *supplementary* quota. Australia's country quota entitlement of 7000 tonnes is comprised of 2614 tonnes historical quota and 4386 tonnes supplementary quota. Each type receives slightly different treatment:

- For *supplementary* quota, the USDA issues import licences to USA importers nominated by Australian exporters through the Australian Government.
- For *historical* quota, the USDA issues import licences to USA importers on the basis of the importer's historical trade. Australia has no influence on the distribution of the licences.

The import licenses form the basis for tracking and monitoring of country quota usage by the USDA. The USA does not require or recognise Australian quota documentation or the quota rights of Australian exporters.

In addition, the USA also allows concessional entry for cheese and other dairy products under its other quota types such as Other Country, Any Country, Globalised

quota and, since 2005, AUSFTA quota. It also allows out-of-quota trade at normal tariffs for which USA licenses are not required by importers.

4.1.11) US WTO quota administration

As noted above, DAFF is responsible for advising the USDA, on an annual basis, the list of USA importers nominated by Australian dairy exporters, so that import licences can be issued for the supplementary cheese quotas. The department is also responsible for allocating all WTO cheese quotas to Australian manufacturers exporting to the USA, as well as managing other aspects of quota administration including the collection of fees, issuing approvals for shipments of regulated products, recording and monitoring quota usage and the withdrawal and re-distribution of quota.

4.1.12) US WTO quota holders

At present a total of six Australian firms hold USA quota entitlements across the 4 types of US WTO quota cheese.

4.1.13) US WTO quota allocation process

Quotas are formally allocated to companies in October each year by the Secretary of DAFF in time for the commencement of the shipping year on 1 November. However, the amount each company receives is generally static. Companies retain the entitlements they were first allocated in 1979 and 1993/94 unless they have formally transferred quota to another entity or are in breach of the usage rules. New entrants cannot receive an allocation except through a permanent transfer of quota from an existing quota holder or if there is a spill of quota following breach of the usage rules. Transfers of quota are rare but there was a reallocation of Swiss cheese quota in 2004 due to continuing under-utilisation by the single quota holder resulting in several new entrants gaining access to the quota.

As noted in 4.1.9 above, the USA classifies WTO quota as either historical or supplementary. A proportion of each firm's annual allocation for each cheese type is therefore historical and the remainder is supplementary. Supplementary quota has been preferred by companies since they are able to nominate an importer through the Australian Government.

4.1.14) US WTO usage rules

An exporter will only lose quota entitlement in a subsequent year if the exporter has not shipped any quota product in the two previous years or if all entitlements are transferred for 2 consecutive years to other exporters. In August each year unused quota may be withdrawn from exporters for the remainder of the quota year unless the exporter advises that the quota will be used. This quota may then be allocated by the Secretary to other exporters for the remainder of the shipping year.

4.1.15) US WTO fees

A fee for the approval of entitlement is prescribed in the Regulations. The fee is designed to provide cost recovery for the management of entitlement to Australia's cheese quotas

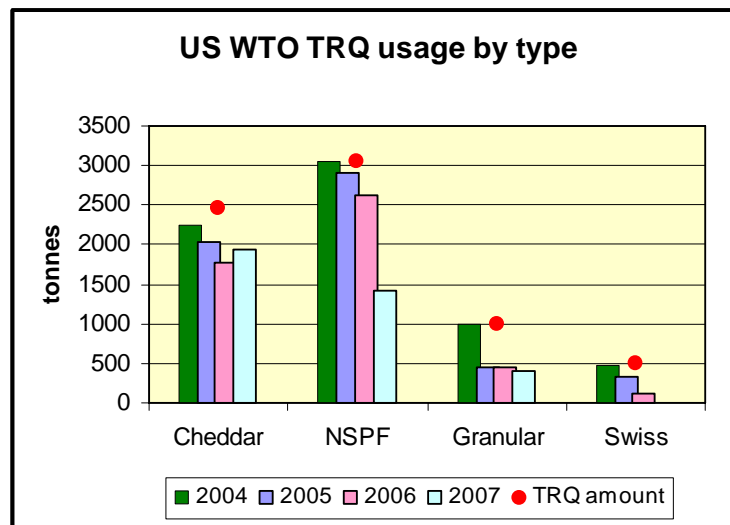
to the USA on an annual basis. The fee is currently set at \$0.007 per kilogram (\$7.00 per tonne) of entitlement approved and is payable in advance.

4.1.16) US WTO quota usage

As can be seen in Figure 1 below, aggregate cheese shipments to the USA against WTO cheese quota have fallen considerably over the past 4 years. A significant reason for the decline in usage is the commencement of the AUSFTA and the restricted nature of the market for WTO quota product in comparison to FTA quota. All current exporters with WTO quota also hold FTA quota. As noted in 4.1.9, WTO quota product can only be sold to importers licensed by the USDA. All licensees must be either dairy processors above a specified size or dairy importers meeting specified import criteria. In some categories there are only one or two buyers. By contrast, US FTA quota product can be sold to a wide range of buyers – retailers, wholesalers, food service industry, food processing sector and importers.

Other important factors contributing to the decline in quota usage include product scarcity due to drought; lower premiums in USA markets and the restricted number of companies with access to the quota.

Figure 1.



4.1.17) AUSFTA dairy quotas

The AUSFTA was negotiated in 2004 and provided Australia with tariff-free access for specified annual quantities of dairy products (i.e. quotas) in 12 broad categories as set out in Table 4 below with access to commence in 2005. The amount of access for each category grows annually by the factor set out in column three of the table. Unlike WTO dairy quotas, the administration of FTA quotas is solely the responsibility of the Australian Government. On request of either Party, after Year 20 of the Agreement, the Parties shall consult on and consider the possibility of modifying market access commitments.

Table 4. Initial access amounts and annual growth percentages

PRODUCT	INITIAL 2005 FTA AMOUNT	ANNUAL GROWTH
Milk/Cream/Ice Cream	7.5 m litres	6%
Condensed Milk	3,000 mt	6%
Butter/Butterfat	1,500 mt	3%
Non-fat Dried Milk Powder / Skim Milk Powder	100 mt	3%
Other Milk Powder	4,000 mt	4%
Other Dairy Products	1,500 mt	6%
Cheddar Cheese	750 mt	3%
American Cheese	500 mt	3%
Swiss Cheese	500 mt	5%
European Cheese	2,000 mt	5%
Other Cheeses	3,500 mt	5%
Goya	2,500 mt	5%

4.1.18) US FTA quota administration

Under the free trade agreement, products entering the USA under any of the quota categories need to be accompanied by a quota certificate that specifies the amount of product and the USA Harmonised Tariff Schedule product code. All quota certificates for each category are issued by DAFF. The certificate is recognised by the USA Government as a condition of import for tariff-free entry.

In addition to issuing quota certificates for AUSFTA quotas, DAFF manages all aspects of quota administration including the collection of fees, the calculation and allocation of quota entitlement for relevant categories, monitoring quota usage and withdrawal of quota entitlement. The management system is outlined below.

The AUSFTA quota categories are managed as either **allocated** or **unallocated** quotas.

Allocated categories are those where dairy manufacturers are issued quota entitlements that can be used throughout the year to ship product or be transferred to other exporters. Unallocated categories are those for which applications for export approvals can be made by any person throughout the quota year until the quota is fully utilised. The unallocated categories are also referred to as first-come-first-served (FCFS).

Most of the above AUSFTA categories are managed as allocated quotas but the category Other Dairy Products is unallocated and the category of Milk/Cream and Ice Cream has been subdivided into sub-categories of which Cream is an allocated category and Ice Cream is unallocated. Detailed rules for the management of allocated and unallocated quotas follow.

US FTA allocated quotas

4.1.19) US FTA categories and products

The categories and amounts allocated in 2005 are listed in Table 5. There is a wide range of products covered by most of the categories and the quota holder is responsible for ensuring that a product has the appropriate specifications for the quota category. Quota holders may seek advice from customs agents or obtain a ruling from the USA authorities. However, DAFF provides guidance on the USA Harmonized Tariff Schedule product codes and possible Australian equivalents in a product equivalence schedule.

Table 5. Allocated categories: total and minimum amounts, rounding factors and set-asides

FTA Category	Total amount for allocation 2005	Minimum Allocation	Rounding Factor	Set-Aside Amount	
Milk and Cream	5 000 000 litres	20000 litres	20000	5%	250 000 lt
Butter/Butterfat	1500 tonnes	20 tonnes	20	5%	45 t.
Condensed Milk	3 000 tonnes	20 tonnes	20	5%	150 t.
Non-Fat Dried Milk Powder & Skim Milk Powder	100 tonnes	20 tonnes	20	0%	0
Other Milk Powders	4 000 tonnes	20 tonnes	20	5%	200 t.
Cheddar Cheese	750 tonnes	20 tonnes	20	5%	37.5 t.
American Cheese	500 tonnes	20 tonnes	20	5%	25 t.
Swiss Cheese	500 tonnes	10 tonnes	10	5%	25 t.
European Cheese	2 000 tonnes	10 tonnes	10	5%	100 t.
Other Cheeses	3 500 tonnes	10 tonnes	10	5%	175 t.
Goya Cheese	2 500 tonnes	20 tonnes	20	5%	125 t.

4.1.20) US FTA company eligibility

In 2005, quota was allocated **on application** and only to dairy manufacturers. In subsequent years, new applicants must also be dairy manufacturers. A dairy manufacturer is a person who collects milk from farms and processes it or purchases dairy produce and subjects it to a process that changes it from one kind of produce to another or repackages it.

4.1.21) US FTA quota transfer

Once an allocation of entitlement has been made to an eligible manufacturer, it may be transferred to another party including non-manufacturers on a temporary or permanent basis. To do this, the transferrer must send DAFF a form advising the details of the transfer including whether it is temporary or permanent. Agency transfers are also permitted to facilitate the use of shipping agents.

4.1.22) US FTA quota entitlement calculation in Year One (2005)

In 2005, the preliminary entitlement for each allocated quota category was calculated on the basis of pro-rata shares of 2002 and 2003 exports and production for that category. The formula to be used is fully explained in the Regulations. The weighting given to exports was twice that given to production.

Export data was drawn from AQIS export records of shipments for the 2002 and 2003 calendar years. For most companies, export data included all exports of products in the relevant category to global markets. For those companies holding WTO quota entitlements, exports of products under these quotas were excluded.

Production data was based on self-reporting by companies for the 2002 and 2003 calendar years.

Where an applicant believed the 2002 or 2003 production years were significantly different from each other and would lead to disadvantage, the applicant could nominate a year to be used for calculations. If the applicant then met the criteria for disadvantage, the nominated year was used for calculations for all categories and for both exports and production. Disadvantage was defined as an increase of 25% or more or a decrease of 25% or more between 2002 and 2003 company production data in 40% or more of the AUSFTA quota categories the company produces. Disadvantaged status recognised that significant events in one year of production would prejudice the company's allocation of entitlement.

Once the preliminary entitlement was calculated, the amounts were rounded up by the rounding factor (either 10 or 20 tonnes) applicable to the relevant category (see Table 5). All applicants on or above the minimum allocation for the category, as shown in Table 5, received a primary allocation. After primary applicants had been determined, each primary applicant's allocation was adjusted proportionally either up or down (but not below the minimum threshold) until the amount left unallocated for the category was equal to the amount of set-aside for the category as listed in Table 5.

All those applicants who fell below the minimum threshold in the preliminary calculations were secondary applicants and shared equally in the set-aside amount for the relevant category (but could not exceed the minimum amount for that category).

4.1.23) US FTA quota allocation: after 2005

Quotas are formally allocated to companies in October each year by the Secretary of DAFF in time for the commencement of the next shipping year on 1 November. Companies that received an allocation of quota in 2005 retain the entitlement for subsequent years subject to any permanent transfers or forfeits (see below). They are also eligible to receive annual increases in entitlement because the total quota

available in each category grows each year in accordance with the percentages set out in Table 4. The annual quota amounts available for distribution since the FTA commenced are set out in Table 6. Distribution of the annual growth amount across quota holders is outlined below.

4.1.24) US FTA quota forfeits

Quota entitlement can be forfeited in the following situations: a) a quota holder will forfeit quota that has been temporarily transferred in two consecutive years (not including 2005). If quota was transferred to the same person for the two years the transfer becomes permanent. If quota was transferred to different persons, the quota is forfeited and redistributed as described below. Agency transfers are treated as if shipped by the original entitlement holder. b) where a quota holder does not ship 95% of its entitlement for two consecutive years, not including 2005, the average of unused quota over the period is to be forfeited and redistributed as described below.

4.1.25) US FTA distribution of annual growth and forfeits

The annual growth percentage for each category is set out in Table 4. Half of this amount (together with any forfeited quota as noted above) is distributed *proportionally* to all primary and secondary quota holders. Note: A primary quota holder is one that holds more than 4 times the minimum allocation for the category (or 5% of the 2005 quota amount whichever is greater) - the remainder are secondary quota holders. The other half of the annual growth amount is distributed *equally* to all secondary quota holders and new applicants.

4.1.26) US FTA management of unused quota

All quota holders with unused entitlement in any category must advise DAFF by 23 August each year how the remaining entitlement will be used. To do this, quota holders must forward a *Quota Approval Application Form* to the Quota Administration Unit for the amount of quota that they intend to use in the remainder of the quota year.

Any amounts not advised will be withdrawn and made available for re-distribution in the current quota year. Companies unable to use their entire available quota in any year may request DAFF to withdraw quota at any time.

Companies wishing to ship product against unused quota that has been withdrawn may do so by forwarding a Quota Approval Application Form to DAFF on or after 25 August.

4.1.27) US FTA new applicants

A dairy manufacturer that has not previously been allocated quota in a category can apply to the Secretary of DAFF for an allocation of quota in that category. Given that existing quota holders will be advised of their following year's entitlement by 1 November, new applicants seeking quota should apply before 15 October.

Table 6. Total quota access amounts 2005-2008 (tonnes)

Quota category	2005	2006	2007	2008
Cream/ice-cream	7,500	7,950	8,427	8,933
Ice-cream	2,500	2,650	2,809	2,978
Condensed milk	3,000	3,180	3,371	3,573
Butter	1,500	1,545	1,591	1,639
Skim Milk Powder	100	103	106	109
Other milk powder	4,000	4,160	4,326	4,499
Other dairy products	1,500	1,590	1,685	1,787
Cheddar Cheese	750	773	796	820
American Cheese	500	515	530	546
Swiss Cheese	500	525	551	579
European Cheese	2,000	2,100	2,205	2,315
Goya cheese	2,500	2,625	2,756	2,894
Other Cheeses	3,500	3,675	3,859	4,052
TOTAL	29,850	31,391	33,013	34,724

4.1.28) US FTA unallocated quotas

As noted earlier, the AUSFTA category of Milk/Cream/Ice Cream has been split into two sub-categories, with one third of the total annual access amount assigned to the Ice Cream sub-category which is unallocated. The only other unallocated category is Other Dairy Products which is split into two sub-categories: 90 per cent of the access amount is for tariff lines with high dairy content (Sub-category A) and 10 per cent is for tariff lines with low dairy content (Sub-category B). Annual total access amounts since the FTA commenced are shown in Table 6.

Persons wishing to obtain quota certificates for unallocated quotas can apply for approvals on or after 1 November each year. Multiple shipments throughout the quota year require separate applications for each shipment. Applications are not restricted to dairy manufacturers. General requirements for an application are:

- No applicant will be approved for an amount greater than one-third of the total quota for the relevant quota year.
- Each application must include information on the amount of quota sought and the USA Harmonized Tariff code under which the product will enter the USA.
- Each application must include the date of proposed export.
- Each application must include evidence that the products will be imported into the USA. This evidence can cover multiple shipments. The evidence may consist of an import agreement or contract, a statement describing such an agreement or conditional agreement or an offer to enter into such an agreement.
- Fees relating to applications will need to be paid prior to quota certificates being issued.

All requests for approval will be dealt with on a FCFS basis. However, it is important to note that if more applications are received on 1 November than there is total quota

available then all applicants on that day will share the quota equally, provided that no applicant receives more than one-third of the quota or more than they requested.

Approvals to export may be withdrawn if the holder of the approval fails to export at least 95% of the specified amount by the date specified in the application for approval or (where delays are beyond the control of the holder) within 28 days of the specified date.

4.1.29) US FTA quota fees

A fee for the application to export AUSFTA dairy quota products is prescribed in the regulations. It is currently set at \$0.007 per kilogram (\$7.00 per tonne). The fee is designed to provide cost recovery for the management of entitlement to all of Australia's dairy quotas to the USA on an annual basis. For the allocated quotas, the fees are advised to quota holders at the time of the allocation advice and collected in advance before any quota certificates or transfers are processed. The fee is based on kilograms of quota allocated.

For unallocated quotas, the fee is based on shipment approvals granted.

4.1.30) US FTA unallocated quota usage rates

As is evident in the charts and table below, fill rates for AUSFTA quotas have declined in most categories since the commencement of the FTA. Possible reasons for this decline include: lower productivity in Australia which has limited exports; comparatively low US prices for some commodities in an environment of very high global prices; and, the closure of some factories producing specific products such as condensed milk.

Chart 1.

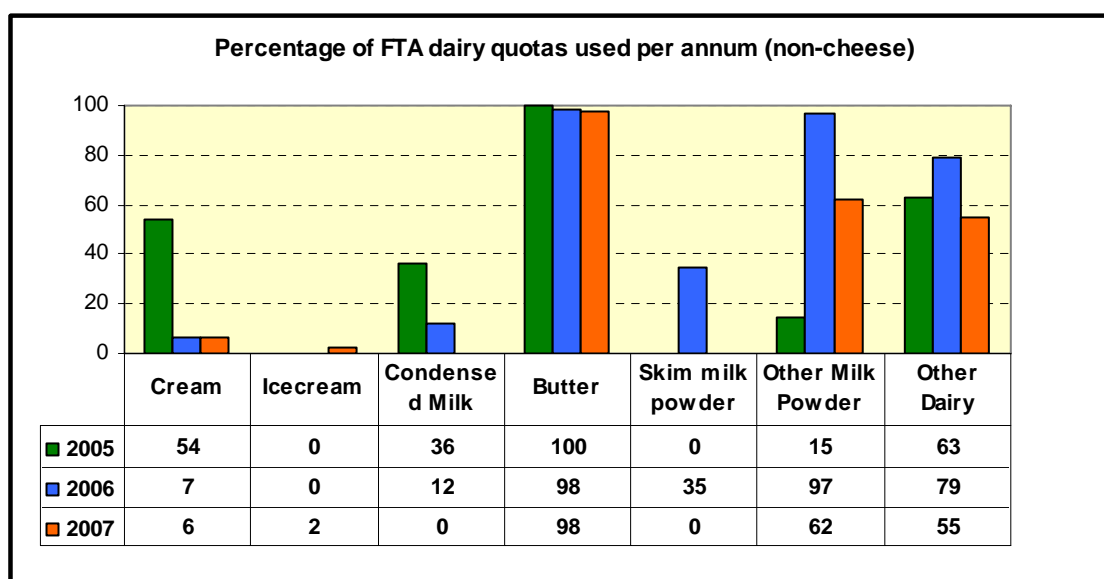


Chart 2.

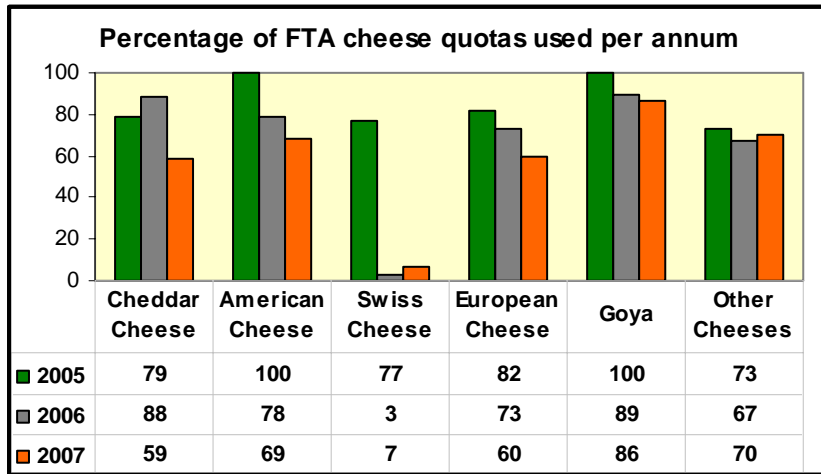


Table 7.

FTA dairy quota exports to the United States 2005-2007			
2007	<i>Quota amount (tonnes)</i>	<i>Amount shipped (tonnes)</i>	<i>% shipped</i>
Butter	1591	1557	97.9
Condensed Milk	3371	0	0.0
Skim Milk Powder	106	0	0.0
Other Milk Powder	4326	2671	61.7
Milk/Cream and Ice cream*	8427	430	5.1
<i>Milk/Cream</i>	<i>5618</i>	<i>360</i>	<i>6.4</i>
<i>Ice cream</i>	<i>2809</i>	<i>70</i>	<i>2.5</i>
Cheddar	796	466	58.5
Swiss cheese	551	38	6.9
European cheese	2205	1321	59.9
Goya cheese	2756	2382	86.4
American cheese	530	364	68.7
Other cheese	3859	2703	70.0
Ice cream*	2809	70	2.5
Other dairy products	1685	924	54.8
2006			
2006	<i>Quota amount (tonnes)</i>	<i>Amount shipped (tonnes)</i>	<i>% shipped</i>
Butter	1545	1517	98.2
Condensed Milk	3180	396	12.5
Skim Milk Powder	103	36	35.0
Other Milk Powder	4160	4037	97.0
Milk/Cream and Ice cream*	7950	363	4.6
<i>Milk/Cream</i>	<i>5300</i>	<i>363</i>	<i>6.8</i>
<i>Ice cream</i>	<i>2650</i>	<i>0</i>	<i>0.0</i>
Cheddar	773	681	88.1
Swiss cheese	525	17	3.2
European cheese	2100	1532	73.0
Goya cheese	2625	2344	89.3
American cheese	515	404	78.4
Other cheese	3675	2475	67.3
Other dairy products	1590	1251	78.7
2005			
2005	<i>Quota amount (tonnes)</i>	<i>Amount shipped (tonnes)</i>	<i>% shipped</i>
Butter	1500	1494	99.6
Condensed Milk	3000	1094	36.5
Skim Milk Powder	100	0	0.0
Other Milk Powder	4000	594	14.9
Milk/Cream and Ice cream*	7500	2703	36.0
<i>Milk/Cream</i>	<i>5000</i>	<i>2703</i>	<i>54.1</i>
<i>Ice cream</i>	<i>2500</i>	<i>0</i>	<i>0.0</i>
Cheddar	750	594	79.2
Swiss cheese	500	387	77.4
European cheese	2000	1643	82.2
Goya cheese	2500	2500	100.0
American cheese	500	499	99.8
Other cheese	3500	2551	72.9
Other dairy products	1500	944	62.9

* all products expressed in tonnes except Milk/Cream and Ice cream which are in litres

Option 4.2) No quota allocation - ‘first-come-first-served’

Under this option a ‘first-come-first-served’ (FCFS) system would operate. The key features of this option are:

- There would be no restrictions on access to FCFS TRQ pools or on the amounts accessed.
- TRQ certificates would be provided on a per shipment basis.
- A per-kilogram fee of around \$0.007 per kilogram (\$7.00 per tonne) would be payable for quota.
- There would be a mechanism to cancel unused certificates to help ensure that quota is fully utilised.
- The new model could be implemented in time for the 2010 quota year.
- DAFF would continue to manage the TRQs on a cost recovery basis and the administrative system would have the flexibility to adjust fees to reflect the needs of cost recovery.

Option 4.3) Combined ‘first-come-first-served’/allocation system

Under this option a ‘first-come-first-served’ (FCFS) system would operate unless there were firm indicators that the demand for access to a particular TRQ will exceed the available TRQ quantity in the forthcoming year. The key features of this option are:

- An annual application process for each TRQ - companies would no longer have on-going rights to fixed amounts of quota.
- Applications for TRQ would be accompanied by a flat fee for each request for an allocation from each TRQ. A per-kilogram fee would also be payable for each allocation.
- Eligibility for TRQ allocations would continue to be restricted to dairy manufacturers, but the definition of manufacturer would be expanded to include sub-contract processing.
- Full allocation of all FTA and EU TRQs would be triggered by demand i.e. if the aggregate volume applied for exceeds the volume of a TRQ then that TRQ would be allocated to companies.
- If full allocation is triggered in a particular TRQ for a particular year, a company would obtain quota entitlements for that year based on a three year moving average of its pro-rata share of its TRQ market and global trade performance compared to the same trade performance factors for all applicants.
- The Panel did not specify the precise formula to be used in calculations of an applicant’s share of entitlement but given the performance basis of the allocation, the government believes the following formula appropriately reflects the intent i.e. the applicant’s share will be the average of its global performance plus its TRQ market performance:

$$\text{Applicants share} = \left(\frac{\text{Applicant's [EU] or [US] exports of TRQ product}}{\text{EU or [US] exports by all applicants of TRQ product}} \right) + \left(\frac{\text{Applicant's global exports of TRQ product}}{\text{Global exports by all applicants of TRQ product}} \right) / 2$$

- There would be an early return mechanism in situations where TRQ is allocated to help ensure that quota is fully utilised. Unused allocations of quota would be returned and made available on an FCFS basis.
- There would be a reduction in a quota holder's next allocation for quota that is not returned under the early return mechanism and is not used by the end of the quota year. This penalty would be a kilogram for kilogram reduction in that quota holder's next allocation from the same TRQ.
- If full allocation is not triggered in any TRQ then quota from that TRQ would be available on a FCFS basis. There would be no restrictions on the sale or transfer of quota or access to FCFS pools.
- There would be provisions to assist small companies and new entrants (SNEs) who receive a TRQ allocation that is below a ten tonne threshold. These applicants would be entitled to an additional share of a set-aside amount of that TRQ. The Panel has recommended that the set-aside amount be two percent of the TRQ for TRQs less than 3000 tonnes and one percent of the TRQ for TRQs equal or greater than 3000 tonnes.
- The new model could be implemented in time for the 2010 quota year.
- DAFF would continue to manage the TRQs on a cost recovery basis.
- The administrative system would have the flexibility to adjust fees to reflect the needs of cost recovery.

There should be some variations in the application of the above recommendations to accommodate differences between the TRQs. These variations are:

AUSTFA Skim Milk Powder TRQ

There should be no SNE provisions for the small AUSTFA Skim Milk Powder TRQ (109 tonnes). This is a very small TRQ for a bulk product and the SNE provisions could create commercially unviable 'parcels' of TRQ.

US historical cheese TRQs

Management of US WTO historical TRQs should cease. USA importers with historical licences are able to buy products from Australian companies without government intervention.

US WTO supplementary cheese TRQs

The USA import requirement to nominate importers for supplementary cheeses makes variations necessary to ensure that the entire TRQ volume is live and is not fragmented into commercially unviable parcels of TRQ. Accordingly, the supplementary cheeses should be allocated irrespective of demand (i.e. should not be available on an FCFS basis), exporters will need to specify USA importers before final allocations of supplementary cheese TRQs are made, and there should be a 10 tonne minimum for allocations.

Any amount of quota in excess of that applied for will still need to be allocated to a US importer or it will not be able to be used under any circumstances.

Option 4.4) Annual allocation of all TRQS

Under this option allocations are made by the administrator on the basis of specific and agreed rules and criteria. Ideally, the key features and settings for this option would be largely the same as the combined option outlined in Option 4.3 with the exception that each TRQ would be allocated irrespective of demand i.e. there would be no mechanism for switching between FCFS and allocations. The allocation formula considered in Option 4.3 would apply to all categories. All other key features of Option 4.3 would apply.

Option 4.5) Auction of each TRQ

Under this option allocations would be made by the administrator based on successful bids for TRQ “parcels” or lots. The key features would vary depending on the type of auction system selected, for example an open auction system vs. a sealed bid system, but may include:

- one or more auctions, perhaps a one-off auction with later access through the secondary TRQ market, annual or in more frequent tranches;
- various TRQ parcel sizes;
- single or multiple rounds;
- eligibility criteria i.e. bidding would be restricted to particular segments of the dairy industry such as manufacturers;
- any profits generated by the auction could be used for the benefit of the dairy industry;
- DAFF would manage the TRQ auctions on a cost recovery basis

5. Assessment of the impact (costs, benefits and, where relevant, levels of risk) on consumers, business, government and the community of each option considered by the independent Panel

The Panel considered four options – maintaining the status quo; first-come-first-served (FCFS); full allocation; and auction. These four options, plus an additional option combining the FCFS and allocation methods, are assessed below.

5.1) Continuation of current arrangements, including fixed allocations for all the EU and the main USA TRQs.

The Panel considered that the current arrangements, with elements established at various stages over the past decades do not, today, accord with the principles of optimising the commercial value of TRQs to Australia in variable market conditions, minimisation of government intervention and minimisation of barriers to export. The

Panel concluded that these factors indicated that a new dairy TRQ management model should be developed.

While the TRQ quantities in question are small, the EU and USA can be valuable markets and should be generally accessible to the dairy industry. The Panel noted that industry was divided on this option, with most participants seeking a quota allocation system that would better reflect more recent export performance, but that a few were seeking retention of the status quo.

The benefits of continuing the current arrangements would be largely confined to existing quota holders because they would have a lot of certainty over their forward allocations. However, one of the principle objectives of TRQ management is to optimise the commercial value to Australia as a whole, rather than to specific entities, and this is no longer achieved under this model in a potentially volatile market environment.

The costs of continuing the current arrangements need to be given consideration. These costs include:

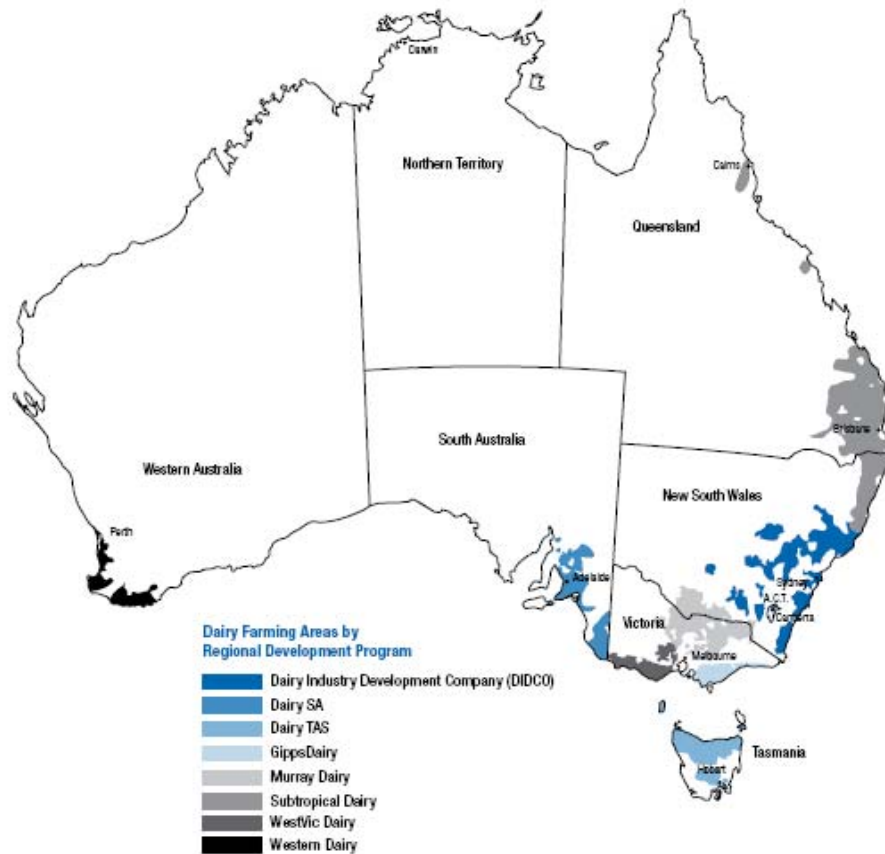
- little or no scope for new entrants.
- complex administrative arrangements as a result of having four different sets of rules governing quota management
- failure to recognise and reward recent export performance (being based purely on historical performance).
- lack of flexibility to adjust to changing market conditions. In particular, industry submissions asked to change ‘use it or lose it provisions’ that redistribute a EU or US WTO TRQ holder’s allocation if they do not ship TRQ product into a TRQ market within a two year period. In any particular year it may be more viable for companies to export (ultimately limited) product to destinations outside the EU or USA which are offering higher economic returns. However, under the current system they potentially risk losing future allocations of quota and may choose to export to the EU or USA despite lower returns merely to preserve their quota allocation.

During 2006/07 the DAFF Quota Unit issued 314 AUSFTA dairy quota certificates or approvals to 53 companies and 98 WTO EU & USA dairy quota certificates or approvals to 9 companies. These recipients come from a range of geographic locations and vary in size from large companies through to small companies. Milk production is concentrated in the south-east corner of Australia, with Victoria, Tasmania and South Australia accounting for 79 per cent of national production in 2006-07. The majority of milk destined for use in export products originates in these regions. Australia’s dairy producing regions are illustrated in Map 1.

Information is not available on how many companies would be excluded from receiving TRQ allocations either in part or in full by continuing the existing arrangements, and the future effects that exclusion from TRQ allocations would have on those companies and the potential returns to the industry and to Australia are

difficult to gauge. However, companies have expressed an interest in the introduction of a more equitable distribution mechanism in submissions to the review.

Map 1.



Source: Dairy Australia, Australian Dairy Industry in Focus 2007.

5.1.1) Compliance Costs

The fees for exporting dairy quota products under the EU, WTO and AUSTFA TRQs are prescribed in the regulations. They are currently set at \$0.007 per kilogram (\$7.00 per tonne) for each of the TRQs. In 2006/07 and 2007/08, the DAFF Quota Administration Unit received \$280 815 and \$220 242 respectively from dairy quota fees. Based on historic usage, the compliance costs to the dairy industry of continuing the current fee arrangements are estimated at \$250 000 per financial year.

There are labour costs involved with accessing the quotas. These are estimated to cost the dairy industry \$3 281¹ per financial year.

¹ The estimated labour costs of all options in this paper are calculated based on the hourly rate (\$19.30) for an Administrative officer Grade 6 described in the *Pay Scale Summary – Clerical and Administrative Employees (Victoria) Award 1999 [AP773032 – Fed]*.

There are also labour costs involved with applying for the quotas on a first-come-first-served basis. Applicants for first-come-first-served quota are required to submit an allocation form detailing the specific amount of quota required, details of forward shipment plans and a copy of the contract with the importer or letter of intent. The labour cost to the dairy industry of meeting these requirements is estimated at \$1 737 per financial year.

5.2) No allocation – ‘first-come-first-served’

The benefits of not allocating a quota are fairly clear-cut in cases where quota fill rates are low *and* there is reasonable certainty they will remain low ie. where the quota is not binding or perceived to be binding on commercial trade. In this situation, all exporters have open access to low-tariff markets to their maximum capacity and at their preferred schedule. Therefore all exporters have the opportunity to maximise quota rents and the market behaves efficiently akin to a free market. Quota revenues would not accrue to Government but to individual exporters involved in the specific market. There would be no scope for a secondary market in quota trade since access is based on actual shipments and there are no entitlements to trade.

Unallocated quotas in their simplest form require little or no management by the administering authority. Access to the quota is available to all exporters until quota is filled. Fill rates are monitored by the receiving country with no intervention required by an administering authority in the sending country. Administration costs range from low to zero. An example of an unmonitored quota, with zero administration costs, is Australia’s WTO chocolate crumb quota to the USA.

However, sometimes a receiving country will require shipments to be accompanied by certificates confirming that a shipment is within quota. This is an EU requirement for cheese and a US requirement under the AUSFTA. In these cases the administering authority is required to issue certificates. The issuing of certificates would need to be supported by a monitoring system to keep track of how much quota remains available at any given time. It follows that all exporters may also require access to this information. In addition, if it is desirable to maximise quota fill, the administering authority will require powers to cancel unused certificates in accordance with agreed rules and make these amounts available to other exporters. The transaction costs for managing these types of unallocated quotas are low to moderate.

Overall, unallocated quotas are relatively cost-effective, equitable and economically efficient and best suited to situations where quota is non binding and perceived as remaining non-binding.

Unallocated quotas are less suitable in situations where the quota is binding on trade or fill rates are unknown. The uncertainty and consequent speculation inherent in this situation would drive many exporters to ship as much product early in the year contributing to price discounting and earlier breach of the quota threshold with no product available to importers for the last part of the quota year. This type of strategic behaviour can be expected to have a distortionary effect, driving down prices and eroding quota rents. It may also result in long-term damage to the market if supply is seen as inconsistent and unreliable. Exporters would have no security of access and would be unable to negotiate long-term contracts based on regular shipments.

Nevertheless, in some situations, unallocated quotas with additional rationing rules might still be effective as interim measures before moving to allocated models.

In particular, additional rationing-type rules may be appropriate for unallocated quota in situations where quota fill is uncertain or where there is potential product diversity and an unknown number of potential participants (for example, with new quotas). An example is the system applied to the Other Dairy Products and Ice Cream categories when the AUSFTA commenced.

Usage rates and rationing of unallocated quota can be controlled through setting a fixed application date or dates and instituting sharing rules for over-subscription on the application date as well as capping of maximum amounts per exporter and time limits for shipments to take place. To support full commercial utilisation of the national quota, any capped amounts for individual exporters may need to be varied later in the quota year. Such rules would make the unallocated system administratively more complex (thereby increasing transaction costs) but it may be the only alternative where future quota fill rates are uncertain or the market is untested. This approach may be useful as a transitional means of establishing or testing the market for a new quota, with subsequent years being allocated, if necessary, to prevent disorderly markets and loss of quota premiums.

The use of rationing rules with unallocated quotas has similarities to allocated quotas in that companies can effectively 'reserve' some quota (against contractual obligations) thereby reducing the threat of disorderly trade. However, it does not provide longer term commercial certainty or predictability and is relatively inflexible given that quota certificates are not tradeable.

5.2.1) Annual compliance costs

The fees for first-come-first-served quota would be set at approximately \$0.007 per kilo (\$7.00 per tonne). Based on historic usage of the TRQs the cost to the dairy industry of these fees is estimated at \$250 000 per financial year.

There would also be labour costs involved with accessing the quotas on a first-come-first-served basis. Applicants for first-come-first-served quota would be required to submit an allocation form detailing the specific amount of quota required, details of forward shipment plans and a copy of the contract with the importer or letter of intent. The labour cost to the dairy industry of meeting these requirements is estimated at \$11 580 per financial year.

5.3) Combined 'first-come-first-served'/allocation system

5.3.1) The Panel's model and other recommendations

The Panel considered that the EU and USA TRQs will be utilised most effectively by Australian exporters where market forces are allowed to operate to the greatest extent possible, with individual firms being able to make decisions in response to domestic, EU, USA and global market signals, but noted that anticipation of full use of a TRQ could engender 'strategic' rather than commercial export decisions, including a rapid fill of small TRQ quantities by large exporters. In accord with Principles 1, 2 and 3 outlined in section 3 above, the Panel assessed that a 'first-come-first-served' (FCFS)

system should operate unless there are firm indicators that the demand for access to a particular TRQ will exceed the available TRQ quantity in the forthcoming year.

Taken in combination, the Panel's recommendations would open up the potential for a redistribution of the TRQs in a more equitable fashion. Introducing the Panel's recommendations does involve a risk that some companies who have enjoyed historical quota allocations may find in future years that competition increases for TRQ allocations that they would previously have received. This would particularly be the case in circumstances where the TRQ category becomes fully allocated, such as the EU TRQs. However, the Panel's allocation formula mitigates this risk by affording a degree of protection to exporters with export trade performance by including it as a significant factor in determining allocations.

Because of the existing FCFS provisions companies are able to apply for spare quota after 23 August. However, while some changes have occurred over time due to amalgamations, closures or permanent transfers of entitlement, the EU WTO TRQs have no provisions for small companies and new entrants (SNEs) and the US WTO TRQs have no provisions for SNEs aside from transfers of TRQ or redistributions following a breach of the usage rules.

The USA TRQs have been undersubscribed recently due to poor market conditions, so the chief change that would be anticipated in these TRQs is that new players would be able to receive allocations with the potential to increase Australia's trade into these TRQ markets.

The Panel believes that this model and associated recommendations best reflect its principles of quota management arrangements. Implementing the Panel's recommendations would:

- add rigour and accountability to the administration of the TRQs;
- permit a greater number of companies to access the quotas by removing barriers to entry;
- involve lesser risks and impacts for the dairy industry than other management options; and
- simplify quota administration arrangements.

5.3.2) Cost recovery fees and charges

The underlying principle is that all costs should be recovered and profits should not be made by the administering body. There should also be capacity to adjust the fees annually to reflect best estimates of future market behaviour as well as any shortfalls from the previous year or any under-collections.

The Panel noted that it is both appropriate and necessary that "DAFF continue to manage TRQ distribution, usage monitoring, availability certification and reporting; and, ongoing costs of dairy TRQ administration continue to be recovered from users of all aspects of this service – there is no justification for taxpayers to cover these costs."

DAFF's role in managing these quotas involves allocation to exporters and/or manufacturers, issuing approvals for quota shipments, recording and monitoring quota usage, withdrawing and re-distributing unused quota, providing product certification and other information to US and EU government agencies, answering queries, maintaining records and managing cost-recovery for administration. During 2006/07 the costs of these services amounted to around \$282 567, of which \$194 007 was related to IT costs; however, DAFF anticipates a significant reduction in IT costs as it shifts to a newer and less expensive IT system.

The Panel examined the subject of government fees and charges before determining that "It appears unlikely that industry or a private entity could supply the scope of Quota Unit services for dairy at a lower cost. However, DAFF should continue to seek and negotiate efficiencies."

As with the existing arrangements, a per-kilogram charge would be payable for allocated or FCFS TRQ. This charge reflects that the benefits of TRQ to an applicant are proportional to the amount of TRQ provided. The current fees are set at \$0.007 per kilogram (\$7.00 per tonne) for all of the TRQs. It is expected that the current settings for this fee would be adjusted according to cost recovery requirements.

The key difference between the Panel's recommended fees and charges and the existing arrangements is the introduction of a fixed application fee (of around \$200.00) to accompany each application for quota allocations from each TRQ category. This fee would reflect that there are fixed overhead costs associated with administering the quotas and providing quota certificates and would also serve to discourage speculative or frivolous applications for quota.

Implementing the Panel's recommended fees is not expected to increase the overall cost of quota administration to industry, but the fees payable by each individual company may change depending on the TRQ volumes provided and the number of different TRQ categories applied for. A key reason for accepting the proposed changes is to open access to all of the TRQs to all dairy manufacturers.

As noted above, the compliance costs of the new application fee would vary according to each manufacturer's requirements. For example, a manufacturer that applies for allocations from each dairy TRQ category would pay about \$3,600 (\$200 x 18 TRQs). However, the actual amount each manufacturer will pay in application fees is likely to be substantially lower because some TRQs have never been used, demand for others has been historically low and every dairy manufacturer does not necessarily produce each type of TRQ product.

It is estimated that the compliance cost of the \$200 application fee for the dairy industry as a whole would be about \$39,800 in total annually. This estimate is based on the current number of allocations (approximately 199) multiplied by \$200 per allocation; however, the actual sum generated by the application fee may be lower depending on demand.

Implementing the Panel's \$200 application fee may increase the proportion of the amount required for cost recovery that is paid by manufacturers who access smaller allocations. This would help prevent any one sector of the dairy industry from

subsidising access to the TRQs for another sector. Any increased burden this fee may represent should be considered in the broader context of the benefits provided by increased access to the TRQs, particularly the proposed expansion of small and new entrant provisions. All manufacturers would continue to pay the per kilo fee to ensure that the benefits received from accessing the TRQs are reflected proportionally in the amount recovered for cost recovery.

The revenue generated by fees and charges would ultimately be a function of demand for the TRQs and the fees and charges would need to be increased or decreased according to cost recovery requirements. It is important to note that the overall cost to the industry of administering the TRQs should be no more expensive than the existing cost recovery requirements and that both administration systems can be adjusted to reflect cost recovery requirements.

If the proposed recommendations are accepted, DAFF would form a government-industry technical working group that would set appropriate cost recovery fees and charges and manage other implementation issues.

5.3.3 Early return and the introduction of a penalty provision

The Panel recommends a mechanism for early return of unused quota where a TRQ is allocated. The reclaiming process would be similar to current procedures. Quota holders should be advised that unused quota will be automatically reclaimed on 15 June each year if there is no response to the DAFF ‘use it or lose it’ notice, or if documentary evidence of intended use is considered to be insufficient.

“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 year. This penalty will be a kilogram for kilogram reduction in a company’s allocation the next time the company applies for and receives an allocated share of the same TRQ.”

- “A company’s allocation of quota from a particular TRQ is deemed to be 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.
- The penalty provisions will not apply to returns that occur before or as a result of the reclaiming process that is completed by 15 June.
- The transfer of unused quota allocations will mean the potential penalty liability will move to the quota recipient. However, penalties could be avoided by transfer to an entity ineligible for allocation (eg. a trader). A rule for the penalty to remain with the transferring entity if the recipient is ineligible to participate in allocations will prevent this possibility.”

Under the existing arrangements there are provisions for the return of unused quota in August; however, a company is not penalised if it decides to keep its unused quota past the return date but does not use it. Introducing a penalty (along with bringing the return date forward in the year) would help ensure that companies return quota that they cannot use, or do not intend to use, so it can be made available to everybody on an FCFS basis. Introducing a penalty would help ensure that the TRQs are fully

utilised and that the Australian dairy industry has the opportunity to receive the maximum benefit from each TRQ.

5.3.4) Compliance costs

A fee of \$200 would be payable for applications for TRQ. It is estimated that there would be between 100 – 200 applications across all of the TRQs. The compliance cost to the dairy industry of this fee is therefore estimated at \$20,000 at the low end of estimates and \$40,000 at the upper end of estimates. There would also be labour costs involved with applying for the quotas. The labour cost to the dairy industry of meeting this requirement is estimated at \$1 930 to \$3 860 per financial year.

A fee of \$0.007 per kilogram (\$7.00 per tonne) of TRQ would also apply. Based on historic usage the estimated cost to the dairy industry of this fee is \$250 000 per financial year. This fee, fixed in regulation, can be adjusted if the DAFF Quota Administration Unit is collecting fees in excess of its costs.

There would also be labour costs involved with accessing the quotas on a first-come-first-served basis. Applicants for first-come-first-served quota would be required to submit an allocation form detailing the specific amount of quota required, details of forward shipment plans and a copy of the contract with the importer or letter of intent. The labour cost to the dairy industry of meeting these requirements would vary depending on the number of TRQs that become allocated. Labour cost estimates range between \$1 737 at the low end of estimates to \$11 580 at the high end of estimates per financial year.

5.4) Annual allocation of all TRQs

Industry submissions to the review requested that each TRQ be fully allocated each year, but the Panel could not establish a need for advance allocation of all TRQs, or any administrative advantage in doing so. The Panel noted that a number of TRQs in the USA have not been filled or near-filled in recent years and that market circumstances indicated this would continue in 2008. The Panel reasoned that a flexible system is needed to determine if allocation is required each year; and decided that where a TRQ is allocated, a mechanism for early return of unused quota would be important.

Under an annual allocation system, allocations would be made by the administrator on the basis of specific and agreed rules and criteria. The allocation formula outlined in Option 4.3 above provides an example of how allocation calculations could be determined. Such a system provides the administrator with significant control over the process, allows for broad public policy considerations to be incorporated into rules and simplifies cost-recovery given that invoices can be linked to entitlements and paid in advance. However, the negotiation of specific rules can be complex and there is a risk that particular segments of the dairy industry would win or lose on the outcomes depending on the rules.

The settings for an administered system can have a significant impact on whether the quota itself becomes trade distorting. For example, allocations based on performance in a specific market and re-calculated each year can encourage strategic behaviour such as the export of low value or even subsidised product to ensure allocations are maintained for future years. This risk can be reduced by including global export performance as well as specific market performance over long periods of time as factors in the formula for calculating allocations. The Panel's formula outlined in Option 4.3 provides an example of these features.

An administered allocation provides all participants with a degree of predictability and thereby increases commercial certainty wherever the demand for quota exceeds supply or where market conditions are such that the rate of quota fill is unpredictable but believed to be high.

A full allocation system for the TRQs is an attractive option for industry members seeking long term commercial certainty; however, the Panel's recommended model for TRQ administration outlined in Option 4.3 has the advantages of a full allocation system and is superior in other respects. For example, the Panel's model could fully allocate the TRQs in circumstances where demand for a given TRQ category equals or exceeds the volume of TRQ available (e.g. the EU TRQs), but it also has the flexibility to make the TRQs available on an FCFS basis in circumstances where demand does not trigger an allocation (e.g. the USA TRQs). The Panel's model for TRQ administration is therefore more likely to realise the full value of the TRQs than a full allocation model.

While fully allocating the TRQs is an attractive option to some industry members, the Panel found that there was neither a need nor an administrative advantage in fully allocating every TRQ category each year and did not support this option.

5.4.1) Compliance costs

A fee of \$200 would be payable for applications for TRQ. It is estimated that there would be between 100 – 200 applications across all of the TRQs. The compliance cost of this fee to the dairy industry is therefore estimated at \$20,000 at the low end of estimates and \$40 000 at the upper end. There would also be labour costs involved with applying for the quotas. The labour cost to the dairy industry of meeting this requirement is estimated at \$1 930 to \$3 860 per financial year.

A fee of \$0.007 per kilogram (\$7.00 per tonne) of TRQ would also apply. Based on historic usage the estimated cost to the dairy industry of this fee is \$250 000 per financial year. This fee, fixed in regulation, can be adjusted if the DAFF Quota Administration Unit is collecting fees in excess of its costs.

There would also be labour costs involved with accessing the quotas on a first-come-first-served basis after the 15 June reclaiming date. Applicants for first-come-first-served quota would be required to submit an allocation form detailing the specific amount of quota required, details of forward shipment plans and a copy of the contract with the importer or letter of intent. The labour cost to the dairy industry of meeting these requirements is estimated at \$1 737 per financial year.

5.5) Auction of each TRQ

The Panel reasoned that an auction mechanism, in theory, would be capable of distributing the TRQ quantity in an economically efficient manner to maximise any benefit flowing to the Australian community.

A key attraction of a TRQ auction system is that higher TRQ prices may help ensure that businesses only obtain amounts of TRQ that they intend to use while leaving the rest available for use by other companies; however, alternative administration arrangements that include provisions to reclaim unused amounts of TRQ for reallocation as proposed in the Panel's model do not restrict trade in TRQs and offer similar benefits with a lesser degree of risk.

Under the auction system, individual companies would have to bear the business risks associated with purchasing quota for future use in a potentially volatile market. Fluctuating prices could reduce the value of their quota held and erode profits, and small parcels of quota may not be attractive to other buyers if wanting to on-sell quota rights.

The Panel found that auctioning TRQ could lead to government retaining the quota rents. This risk could be mitigated by legislating that any profit would be returned to the Dairy Industry. However, although the government could direct any benefits back to Industry, the auctioning process itself may lead to a public/industry perception that the government is profiteering from the US and EU quotas.

As demand is unknown at the start of the shipping year, under an auction system, an auction would have to be held for every category for product to both the EU and USA. The alternative would be to undertake preliminary action to determine demand – for example, through an application process (as in the model to allocate quota in one or more of the dairy export categories) - and only apply the auction model to categories with excess demand. This has the potential to make the whole process administratively costly and burdensome. In addition, actual demand could not be accurately determined as prices would not be known until the auctions took place.

The Panel noted that auctioning dairy quotas has no precedent or support from industry and was not considered further. The Department of Agriculture, Fisheries and Forestry does not support an auction system.

5.5.1) Compliance costs

It is not possible to estimate the administrative cost to industry of managing an auction system because there is no precedent for a dairy quota system of this type. The annual labour costs to the dairy industry of an auction system would depend on whether an open or closed auction system is implemented and the degree of demand for the TRQs:

- open auction labour costs are estimated at \$15 440 (100 attendees for 8 hours at \$19.30 per hour) at the low end of estimates to \$30 880 (200 attendees for 8 hours at \$19.30) at the high end;

- closed auction labour costs are estimated at \$1 930 (100 ‘bidding forms’ completed and submitted at \$19.30 per form) at the low end of estimates to \$3 860 (200 ‘bidding forms’ completed and submitted at \$19.30 per form) at the high end.

6. Consultation statement

The Panel consulted widely with all sectors of the dairy industry and relevant government authorities. The objective of this consultation process was to seek comments from interested parties on the appropriateness, effectiveness and efficiency of the current management of WTO and AUSFTA TRQs, and any changes that they considered might serve to improve the existing processes.

Submissions were sought in March 2008 through advertisements in major national and rural newspapers. The DAFF website (www.daff.gov.au/quota) provided further information on the review. The Panel also invited parties making submissions to the report to meet with the Panel.

All registered exporters of dairy products were contacted directly by facsimile. The Panel also sought the assistance of the Australian Dairy Products Federation and the industry services organisation, Dairy Australia in circulating notices. In addition, the Panel chair actively contacted several organisations, including the Australian Speciality Cheese Association and individual business entities to confirm they did not wish to provide a separate written submission or to meet with the Panel to discuss the issues. The Panel held a face-to-face meeting with K L Ballantyne, but many companies declined the invitation to meet face-to-face.

The Panel received submissions from dairy manufacturing companies, industry organisations, DAFF and a USA trading company. ADIC noted its submission incorporates the views of key milk processing companies and traders who have been involved in exporting dairy products to the USA and the EU since 1 January 2005. A majority of dairy manufacturers supported the ADIC submission and as such did not make individual submissions. In addition the views of industry associations were sought including ADPF, ADF and the Australian Speciality Cheese Association and Dairy Australia.

Briefings were provided to the Panel by senior staff from the DAFF Meat, Wool and Dairy Branch and the Multilateral Trade Branch, and the Quota Administration Unit. The Panel also obtained briefings from Dairy Australia and ABARE.

A summary of the issues raised in these submissions is available at [Appendix A](#). The submissions and other consultations were carefully considered during the Panel’s deliberations and are reflected in the Panel’s recommendations. For example, requests that are addressed by the Panel’s recommendations include:

- fairer and more equitable allocation provisions;
- a system that recognises the current market conditions and is not based solely on historical information;

- provisions for dealing with unused quota and to bring the reclaiming date for unused quota forward in the year;
- provisions for SNEs;
- that local industry should be able to capture the economic benefits of the TRQs; and
- efficient and cost effective management.

In addition to the consultation outlined above two government-industry meetings on the recommended changes to dairy quota administration developed by the Panel were held on 20 August and 14 October 2008. Attendees at these meetings included dairy exporters to quota markets and representatives of the Australian Dairy Industry Council and the Australian Dairy Products Federation. These meetings were also attended by DAFF officers.

The Panel Chair, Mr John McQueen, presented the Panel's recommendations at these meetings. These presentations were followed by question and answer sessions.

No major issues or flaws were raised during these meetings that would undermine the Panel's key recommendations about introducing the proposed quota allocation model. However, some lesser concerns were discussed about the proposed FCFS provisions, the size of the proposed SNE provisions, fees and charges and the timing of the proposed changes. There was broad agreement among attendees that these settings could be finalised by a government-industry working group that would also be tasked with reviewing the draft regulations and resolving any technical implementation issues.

7. Conclusion and recommended option

The key determinants for an appropriate quota management system centre around anticipated quota fill rates and market maturity. An FCFS system appears to be the optimum method where quota fill rates are low or where the market is immature whereas allocated quotas can be structured to discourage strategic behaviour where quota is expected to be fully utilised. Allocated quotas in Australia have traditionally been administered on rules-based systems whereas an auction system is likely to face significant industry resistance. A combination of approaches such as the approach outlined in Option 4.3 may be appropriate if quota is not expected to be filled but where fill rates are nevertheless expected to remain high. However, the rules for combination approaches need to be carefully tailored and negotiated with industry to minimise unintended effects and to ensure compliance with principles of equity, transparency, economic efficiency and administrative simplicity.

The TRQ administrative options presented in this paper are ranked in the below table.

Rank	Option	Costs	Benefits
1	Combined 'first-come-first-served'/allocation system	Estimated costs to industry range between \$274 000 to \$305 000 per annum. Less commercial certainty than the existing arrangements.	Is responsive to changing market conditions and would discourage strategic behaviour. Provides benefits to a broad range of companies and to the community. Provides a more equitable mechanism for distributing the TRQs and opens the TRQs up to new players. Is the system most likely to maximise the value of the TRQs. Is aligned with industry submissions. Would simplify administrative arrangements and be easier for exporters to understand.
2	Annual allocation of all TRQs	Estimated costs to industry range between \$274 000 to \$296 000 per annum. Lacks the flexibility of a FCFS system and is less responsive to market conditions than the preferred option. May encourage strategic behaviour. Is less likely to realise the full value of the TRQs than the preferred option.	Provides benefits to a broad range of companies and the community. Allocations provide commercial certainty to businesses. Is aligned with industry submissions
3	Continuation of current arrangements, including fixed allocations for all the EU and the main USA TRQs	Estimated cost to industry: \$255 000 per annum. Allocations are fixed by historical agreements. Does not reward innovation and has limited provisions for small and new entrants. Administratively complex and difficult for exporters to understand.	Secure TRQ access for current TRQ holders.
4	First-come-first served	Estimated cost to industry: \$262 000 per annum. May encourage strategic behaviour. No commercial certainty.	Is perhaps the most efficient way to administer quotas in situations of low demand. Opens each of the TRQ categories to everyone.
5	Auction of each TRQ	Estimated labour costs to industry depend on the selection of an open or closed auction. Estimated labour costs for an open auction range between \$15 000 to \$31 000 per annum. Estimated labour costs for a closed auction range between \$2 000 to \$4 000 per annum. The cost of purchasing the TRQs at auction would be determined by the market. TRQ prices at auction may reduce the profitability of trading TRQ products into TRQ markets in circumstances of high demand.	The market determines the value of the TRQs. Opens each of the TRQ categories to everyone.

7.1) The recommended option: combined ‘first-come-first-served’/allocation system

Adopting the Panel’s performance based allocation model and the majority of its other recommendations would provide a fairer, more effective, and more efficient way of administering the dairy TRQs than is currently available. There are, however, some recommendations that DAFF considers would benefit from further refinement:

- It may be desirable to include a rule which permits partial allocations of TRQs in the event that demand is insufficient to trigger an allocation. Should this situation arise, it is proposed that each applicant for TRQ should receive the amount of TRQ they have requested with the residual TRQ being made available on an FCFS basis, rather than no applicants receiving an allocation. This would provide companies with the commercial certainty to negotiate contracts with buyers knowing that they have the quota available to fulfil these contracts. This should not negatively affect other companies because in this situation they would not have applied for any quota and any residual amounts would be available for FCFS and after unused quota is returned mid-year.
- There should be provision for SNEs; however, there is concern that the amount of assistance provided to SNEs under the recommended provisions is much lower than under current arrangements. These provisions include the 10 tonne cap beyond which no additional assistance will be provided and the overall amount which is to be made available to all SNEs that ranges from one to two percent of each TRQ. DAFF proposes a higher cap than recommended by the Panel in the order of 60 tonnes for cheeses and 80 tonnes for bulk milk products. DAFF also recommends increasing the set-aside amount per TRQ category from one or two percent to 5 percent. DAFF recommends that the final settings for the SNE provisions be determined by a government-industry technical working group.
- The Panel recommended that the new model and their other recommendations should be implemented in time for the 2009 quota year. This timeframe was not feasible because dairy exporters had already made commercial arrangements for the 2009 shipping year, which began on 1 November 2008, and there was not enough time to develop and implement the necessary legislation. The government therefore recommends that the new model and recommendations are implemented at the earliest opportunity, which is the 2010 quota year.

It is anticipated that there may be some other technical and implementation issues, such as the fee settings for cost recovery, that will need to be resolved and recommends that these and the above issues are worked through by a government-industry implementation working group.

7.2) Regulatory effect of TRQ administration on trade

The TRQs represent a net benefit to industry because out-of-quota shipments of TRQ type products to TRQ markets attract prohibitive tariffs. Tariffs are externally imposed restrictions on trade. Paying ‘out of quota’ tariffs represents a far higher cost to exporters than the cost recovery fees and charges imposed by the government to administer the dairy industry’s continued access to the TRQs.

The Australian Government will continue to seek the reduction or removal of the US and EU dairy tariffs; however, until such a time as these tariffs are removed it is likely that there will be a need for the Australian Government to be involved in administering and regulating the US and EU TRQs in one form or another.

Under these circumstances it is important for the government to reduce the burden of administering the TRQs on industry by ensuring that quota arrangements are as appropriate, effective and efficient as possible. In this context, the government considers that implementing the agreed recommendations would help create a system that is less burdensome on the dairy industry than the current arrangements.

8. Implementation strategy and review of the preferred option.

If accepted the recommended changes would be implemented by amending the *Dairy Produce Regulations 1986* and a government-industry working group would be established to manage the implementation of new dairy quota arrangements to the extent approved by the government and based on the model developed by the independent 2008 Quota Review Panel. The new arrangements would take effect before the 2010 shipping year (November 2009).

Any quota administration methodology needs to be established within a framework of regular review. Therefore if market conditions change over time, new suppliers emerge or unintended consequences become apparent, industry can be assured that these factors can be addressed during the next review. If accepted, the regulations and the new model will be reviewed after five years in line with government best practice regulatory review cycles.

To ensure transparency and that on-going fees and charges are set at appropriate rates, DAFF will prepare a short annual statement each year detailing revenue, expenditure and forward cost estimates of managing the dairy TRQs on a cost recovery basis.

Meat Industry Policy
Agricultural Productivity Division
Australian Government Department of Agriculture, Fisheries and Forestry
Nov 2008

Attachments

Report of the 2008 Dairy Quota Review Panel on Administrative arrangements for EU and USA Dairy Quotas managed by Australia

Industry Consultation Extracts

Trugman-Nash Inc argued that due to the current USA dairy product prices being well below world market prices, Australia's 2008 TRQs will not be filled. However, the company argued that this situation would not always be the case and that the review should be mindful of those Australian companies that have successfully penetrated the USA market.

Warrnambool Cheese and Butter Co. Ltd (WCB) commented that it supports the current AUSFTA dairy TRQ arrangements as they provide equitable allocation of quota including a provision for new entrants and they provide for reallocation of under-utilised quota.

WCB believes there should be a minimum allocation of a container load of product and there is no need for additional provisions for incentives or penalties for quota utilisation.

In addition, WCB believes there should be a test on commercial incentives from the USA market compared to world markets and where the USA market prices are not competitive a penalty for under-utilisation or non-use of quota should not apply.

WCB argued that the current EU cheese TRQs have been in place for some 30 years and suggested the "review presents an important opportunity to improve the rationale for EU quota allocations, better reflecting developments in industry since these allocations were originally made."

WCB also argued, as with the AUSFTA dairy TRQ, Australia 'owns' the entitlement to the EU TRQ access and is in a position to extract better margins.

WCB also argued that the principles for TRQ management adopted for the AUSFTA TRQ be adopted for the EU market, including:

- available to a broad range of industry participants under consistent eligibility criteria;
- equitable across firms recognising the current nature of industry and trade;
- allow local industry to capture the economic benefits;
- provide security of access to quota holders;
- that there be provision for new entrants by setting aside 5% of the quota;
- allocations should be based on a base period of 2 years to June 2008 with a weighting of two-thirds exports to one third Australian production;
- that there are provisions to deal with unused quota; and
- efficient, cost-effective management.

The company argued that changing the EU TRQ management arrangements would allow a consistent approach by industry and government to all Australian dairy TRQs instead of the four methodologies currently in place.

WCB argued that all other USA TRQs should be brought into line with arrangements under the AUSFTA.

Fonterra Australia Pty Ltd said “it should be noted that at present dairy export trade to the USA (mainly cheddar cheese) is not profitable. Nonetheless Fonterra values the USA dairy quota and the future trade opportunities with the USA.” it argued that due to these market conditions “the current application of the ‘use it or lose it’ penalties should only apply if trade is commercially profitable in the 6 months preceding the cut-off date.”

Fonterra argued they “would support a mechanism being developed which recognises the commercial situation of better returns being made in other markets (USA wholesale prices are below prevailing commodity FOBs in 2007/2008) and the strong domestic demand for milk which has meant the filling of quota can be a challenge and at time not commercially viable.” It suggested that to avoid penalties a company should be able to export 75% of its quota rather than the current minimum of 95%.

Fonterra stated that it is “supportive of the existing (status quo) EU dairy export quota and administration system”. It also felt that combining the AUSFTA and WTO quota management “would not necessarily improve transparency, cost effectiveness and market access.”

Fonterra suggested that DAFF fees should be based on certificates issued rather than tonnes of product shipped as is current practice.

Australian Dairy Industry Council Inc (ADIC) provided a comprehensive submission which reported on outcomes of a widespread consultation process of dairy companies and traders who have been involved in exporting dairy products to USA and the EU since 1 January 2005. A range of industry associations were also consulted. These included Australian Dairy Products Federation, Australian Dairy Farmers Ltd, the Australia Specialty Cheese Manufacturers Association, and the dairy industry services organization, Dairy Australia.

The following is a summary of the views expressed in the submission on a range of issues arising from the terms of reference for the review:

- retention of the current management within DAFF is appropriate subject to meeting certain industry concerns;
- all dairy product TRQs should be allocated, i.e. abolish first come first served;
- for ingredient and commodity processors a minimum allocation of one full container should be applied;
- company viewpoints diverged over access to existing TRQs for established and new entrants with some companies supporting the status quo while others argued that quota allocations should be based on more recent export performance – these concerns related primarily to trade in cheese to the EU and USA;

- support for new entrants but with provision for a mechanism to minimise allocations to companies in a speculative (quota rent seeking) manner;
- support for the flexibility of the current quota transfer provisions but with a change to the quota usage cut off date of 23rd August to an earlier date – this would provide more time for another company to make effective use of any unused quota;
- support for penalties to be applied for non-use of quota but with a mechanism developed to apply a commercial test to the ‘use it or lose it’ penalty to ensure “companies are not put in a position of having to fill quota to retain quota in the knowledge that returns are (substantially) higher in other export markets.”;
- that the legislative framework for administering quota be changed “from a time consuming ‘regulation’ approach requiring up to four months hiatus to the administratively speedier ‘order’ system.”;
- the panel should recommend transition arrangements to accommodate a major policy change in view of the relatively short time between the report to the Minister and the start of a new quota year.

ADIC Recommendations

AUSFTA TRQ

That the principles that were originally agreed in 2004 for the management of AUSFTA quota be retained but with the following changes:

- the ‘use it or lose it’ provision should only apply if, from 1st January of the quota year, export trade to the USA is commercially viable and profitable relative to other markets – if the trade is not commercially viable then the penalty should not be applied (the industry provided detail of commercial benchmarks that could be used to apply this test);
- to avoid non-performance penalties, a company must export 75% of its quota rather than the current minimum of 95%;
- the cut-off date for return of uncommitted quota should be brought forward from 23rd August to 23rd June to allow sufficient commercial time for unfilled quota to be taken up by other exporters;
- the “Other Dairy Products Category” should be treated the same as other TRQ categories (i.e. allocated); and
- all currently unallocated dairy categories should be allocated.

EU WTO TRQ

“Some companies desire no changes to existing arrangements, while others would like there to be an allocation of the two EU product categories (cheddar and cheese for processing) based on market performance.”

Fees be based on a charge per certificate rather than on a per tonne shipped basis.

Additional Industry Information Sought by the Panel

Following a meeting with the ADIC, the Panel sought additional comment from industry on a range of issues and the ADPF provided a response that is summarised as follows:

- They provided the Panel with three suggested definitions of a manufacturer. These were a firm that:
 - - collects milk off farm and processes it into finished product;
 - - purchases milk/cream from other firms and processes it into finished products; or,
 - - purchases dairy products from a dairy manufacturer and then undertakes reprocessing that substantially transforms the purchased input before resale.
- Provided more detail on mechanisms that could be applied to a 'commercial reality' test for addressing the industry request to suspend the 'use it or lose it' rule in times of poor returns from a TRQ market.
- There is no good reason for Australia continuing to allocate historical USA (cheese) TRQ as this policy is implemented by the USDA for the benefit of their dairy importers.
- For consistency purposes, the 'use it or lose it' rule should apply to the EU WTO TRQs along the same lines that the ADIC submission outlined for USA TRQs including reducing the fill rate to 75% and the application of the 'commercial reality' test.

Australian Dairy Farmers Ltd provided a brief submission to the Review outlining the following set of principles the Panel might like to consider when completing the review:

- There are different allocations of quota, some of which have been in place for 30 years. Their value must be maximised for the benefit of the Australian economy, the broader community, but also importantly the dairy farmers of Australia who have invested over time in the development of this access to markets.
- During these thirty years the dairy industry has changed markedly and is now totally different in structure with very different channels to market. The review should take account of these changes.
- Dairy farmers want the TRQ values maximised and therefore believe there needs to be a balance in the ability of everyone to have an opportunity and the need for commercial shipments, which are necessary if trade is to take place.
- Critical to dairy farmers is that the management cost of securing trade through these TRQs is efficient and the costs are minimised and reflect fairness and equity.