Submission No 12

Inquiry into Australia's trade and investment relationship with Japan and the Republic of Korea

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JOINT STANDING COMMITTEE ON FOREIGN AFFAIRS, DEFENCE AND TRADE
TRADE SUB-COMMITTEE

INQUIRY INTO AUSTRALIA'S TRADE AND INVESTMENT RELATIONSHIP WITH JAPAN AND THE REPUBLIC OF KOREA

SUBMISSION ON JAPAN

July 2011

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Note: Currency values referenced to a particular year, for example, '2009-10 A$b', are 'real values'. That is, they are adjusted to remove the effect of inflation and expressed using the value of the currency in the specified year.

FOREWORD

On 21 April 2011, the Minister for Trade, the Hon. Dr Craig Emerson MP, asked the Joint Standing Committee on Foreign Affairs, Defence and Trade (the Committee) to inquire into and report on Australia's trade and investment relationship with Japan and the Republic of Korea.

The following submission is made by the Australian Government Department of Agriculture, Fisheries and Forestry ('DAFF' or the 'Department') for Japan, addressing the Committee's terms of reference, being:

- *the nature of Australia's existing trade and investment relations;*
- *emerging and possible future trends in these relations;*
- *barriers and impediments to trade and investment with Japan and the Republic of Korea for Australian businesses;*
- *opportunities for deepening existing commercial links, and developing new ones, with Japan and the Republic of Korea; and*
- *the role of the government in identifying new opportunities and assisting Australian companies to access existing and potential opportunities in Japan and the Republic of Korea.*

This accompanies a separate submission also made by DAFF on Australia's trade and investment relationship with the Republic of Korea.

OVERVIEW

Japan is Australia's largest and most valuable export market for food and agriculture products. Australia's agricultural, fisheries and forestry relationship with Japan is important to the Australian Government. In many respects, Australia and Japan are natural partners in the region, with shared democratic and market economy ideals, but differing natural endowments including of land and natural resources. Australia looks to Japan as a friend in the region, and a trusted commercial partner.

The agricultural relationship with Japan is a part of a broader partnership that has been beneficial to the economic and physical security of both nations. In trade, Japan has benefited from Australia's comparative advantage in the production of commodities, including agriculture products that are regarded as clean and green, and resources, while Australia has benefited from Japan's comparative advantage in manufacturing and technology.

Australia's relationship with Japan has not been static. While Australia's trading relationship began as being dominated by agriculture, increasingly trade in mineral and energy resources characterise the relationship. Australia is Japan's third-largest market for automobiles, in spite of the Australian car market being relatively small by global standards.

Agriculture remains an important part of the trading relationship, even as the composition of agricultural trade has changed. Exports to Japan of Australia's past economic staple of wool has largely subsided as processing capacity shifted to lower-cost countries in the region. Now, beef, cereals, dairy and high quality seafood, dominate agricultural trade. Japan's exports to Australia have transitioned from basic manufactured goods including clothing and textiles, to some of the world's most advanced technology items.

Looking ahead, Australia's agricultural relationship with Japan can be expected to continue to evolve. In Australia, agricultural challenges are being addressed, such as through better allocated water resources and increasing the resilience and adaptability of farmers facing the effects of a more variable climate. Australia is aware of these challenges, and is actively managing them and pursuing solutions that will ensure that Australia can continue to be a major exporter for the region.

Other activities that exemplify the Australian Government's proactive approach is its investments to improve the sustainable use of the natural resources that support farming; its work to reform Australia's biosecurity arrangements; its investments—in partnership with farm industries—in research and development that contributes to Australian farm productivity. These efforts will improve the sustainability and resilience of Australian agriculture.

Japan is also working to address the challenges that confront it. In the immediate future, Japan continues to face the challenge of reconstruction following the events of 11 March 2011—the Tōhoku earthquake and the subsequent tsunami and incident at the Fukushima Dai-ichi Power Station. This disaster claimed tens of thousands of lives, displaced hundreds of thousands more, destroyed the economic basis of many coastal communities, and problems at the Fukushima Dai-ichi Power Station are yet to be resolved.

Other factors that may affect the trade relationship include likely protracted population decline, a slow economy and an agriculture sector that is increasingly unable to meet Japan's food

security needs, in spite of extensive government protection and intervention. While Japan will continue to be a key market, Australia's commercially focused agricultural sector will seek out—and has been seeking out—opportunities in other markets. The value of Australia's agricultural exports (in real terms) to Japan has been declining while exports to other Asian markets have increased.

Bilaterally, entering into a high quality and comprehensive free trade agreement with Australia, that includes commercially meaningful outcomes on agriculture, is a priority for the Australian Government.

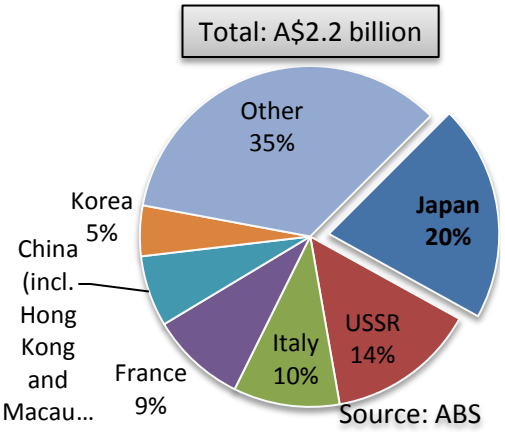
Overall, there is much to celebrate in the relationship that Australia has with Japan, including in agriculture. Our familiar business cultures, the trust that we have in each other, and the depth of our relationship bode well for the future.

THE NATURE OF AUSTRALIA'S AGRICULTURAL TRADE AND INVESTMENT RELATIONSHIP

Japan has been for many decades Australia's most valuable export market for agriculture, fisheries and forestry products. Japan is also a major investor in Australian agriculture, fisheries, forestry and food, including in dairy, livestock and beverages. These trade and investment linkages have been valuable for both countries and underpin the economic and cultural relationship between Australia and Japan.

THE HISTORY OF AGRICULTURAL GOODS AND SERVICES TRADE AND INVESTMENT

Trade in wool was prominent in the early years of Australia's trading relationship with Japan. In the 1970s and 1980s, Japan was Australia's largest export destination for wool. In 1988-89, Japan received 20% of Australia's clip.



Since then, Australia's wool exports to Japan have declined. While there have been many contributing factors, wool processing has shifted to lower-cost Asian countries. Today, Japan receives around 1 per cent of Australia's wool clip. Although the total volume of Australia's wool exports have declined, most of Australia's wool—around 72 per cent—is purchased by and processed in China. Many of the early wool textile activities in China were jointly or wholly-owned ventures for re-export to Japan.

In 2006, the then Australian Bureau of Agricultural and Resource Economics (ABARE) published a research report[1] considering factors driving change in Japanese agriculture. The report also provided some historical context, which is still current. The department has drawn from that report here.

Japan's policy framework

Policy objectives and directions for agriculture in Japan are set down in agricultural basic laws that have been enacted in 1961 and 1999[2]. In the 1961 law, maintenance of farm incomes in line with urban workers' earnings was a key objective. The 1999 basic law's objectives were to secure stable food supplies, to foster sustainable agricultural development, and to ensure the development of rural areas.

As well as the role of agriculture as a source of food, emphasis is given in the current basic law to the 'multifunctional roles of agriculture'. Those roles are defined to include the maintenance of the stability of people's lives, stable production in rural areas, conservation of land, water and the natural environment, the

[1] Roberts, I., Warr, S. and Rodriguez, G. 2006, Japanese Agriculture: Forces Driving Change, ABARE Research Report 06.24, Prepared for the Australian Government Department of Agriculture, Fisheries and Forestry, Canberra, December.

[2] A new basic law has been in development, and has been delayed due to the impact on Japanese agriculture of the triple disasters that struck Japan in March 2011.

formation of a good landscape and the maintenance of cultural traditions.

Subordinate to the basic law are Food, Agriculture and Rural Basic Plans. The most recent of these was issued in March 2010.

Japan uses an array of policies to support agriculture, including high tariffs, for which Japan's average MFN-applied tariff for agriculture is 15.7 per cent, quota restrictions, subsidies directed towards many different ends, import tenders and elaborate marketing schemes often involving state owned enterprises. In 2008 and 2009, support to Japan's farm producers, as measured by the OECD's Producer Support Estimate, was 48 per cent, approximately, twice the OECD average. Most of this support is 'distorting'; that is, support is largely contingent on farm production. According to the OECD, 90 per cent of Japan's farm support is of this nature. Between 2007-2009, total support to agriculture was 1.1 per cent of GDP. Agriculture's contribution to Japan's GDP was 1.2 per cent.

The OECD[3] notes that Japan's agricultural policies, while having succeeded in raising farm household income levels, have drawn excess resources into agriculture. This comes in spite of the pull for labour, land and other resources from more productive areas of the economy, where Japan has a comparative advantage.

Import dependency and Japan's food security

Japan is currently the world's biggest net importer of food. Japan's food and agriculture policies have been debated among Japan's many interested groups, including consumers, farmers, policymakers and researchers. Because Japan's import dependency for food is higher than many other countries, post-war experiences of famine and concerns about the possible impact of food shortages and food embargoes have been used to justify policies that aim to attain a high level of food self sufficiency. These policies include the full range of interventions seen in Japanese agriculture, including tariffs, non-tariff measures, statutory import and marketing arrangements, subsidies and more. These measures come at a high cost to Japan because consumers, who are also taxpayers, meet the cost of these arrangements through higher food prices and higher taxes.

Before the period of rapid industrialisation and economic growth from the 1950s until 1992, Japan was largely self-sufficient in food. In 1955, its self-sufficiency rate in terms of actual calories consumed was 95 per cent. Demand for food has since increased, however, because of both income and population growth, Japanese food production has not been able to keep pace with the increases. Food self-sufficiency in terms of calories has fallen to around 40 per cent in recent years. Self-sufficiency rates for agriculture as a whole and for major commodities are shown in Table 1. It is evident that Japan has a high level of self-sufficiency in rice and a low level for wheat. It is also apparent that self-sufficiency rates have been declining over time for livestock products, fruit and vegetables. The one major commodity for which self-sufficiency rates have risen markedly since the early 1960s is sugar.

[3] OECD, *Evaluation of Agricultural Policy Reforms in Japan*, Paris, 2009, available online at www.oecd.org/dataoecd/26/45/42791674.pdf

Table 1 Japan self-sufficiency rates of selected food products on a calories basis

	1960 %	1970 %	1980 %	1985 %	1990 %	1995 %	2000 %	2003 %	2009 % est.
Rice	102	106	100	107	100	103	95	95	90
Wheat	39	9	10	14	15	7	11	14	14
Vegetables	100	99	97	95	91	85	82	82	83
Beef	96	90	72	72	51	39	34	39	44
Pork	96	98	87	86	74	62	57	53	57
Chicken	100	98	94	92	82	69	64	65	73
Milk and milk products	89	89	86	85	78	72	68	69	69
Sugar	18	23	29	33	32	31	29	35	n/a
Fruits	100	84	81	77	63	49	44	44	41
All food (calories basis)	**79**	**60**	**53**	**53**	**48**	**43**	**40**	**40**	**n/a**

Source: MAFF (Ministry of Agriculture, Fisheries and Forestry), 2005a, The 79th Statistical Yearbook of Ministry of Agriculture, Forestry and Fisheries: Japan: 2003-04, Tokyo (and previous issues), in ABARE 2006. 2009 estimates are on a volumetric basis calculated by the author from MAFF 85th Statistical Yearbook of Ministry of Agriculture, Forestry and Fisheries, at http://www.maff.go.jp/e/tokei/kikaku/nenji_e/85nenji/other/n610_611.xls accessed on 13 July 2011.

During this period, Japanese diets, which traditionally had a strong emphasis on rice, vegetables and fish, have become more diverse, with the inclusion of more meat and dairy products that Japanese domestic agricultural production has been unable to supply sufficiently. Diets have been modified rather than revolutionised, however, with the traditional staples retaining a dominant position. Consumption of meat and dairy products, though having increased from a low base in large part to the influence of US and Western diets and culture generally, is still low relative to levels in other developed countries.

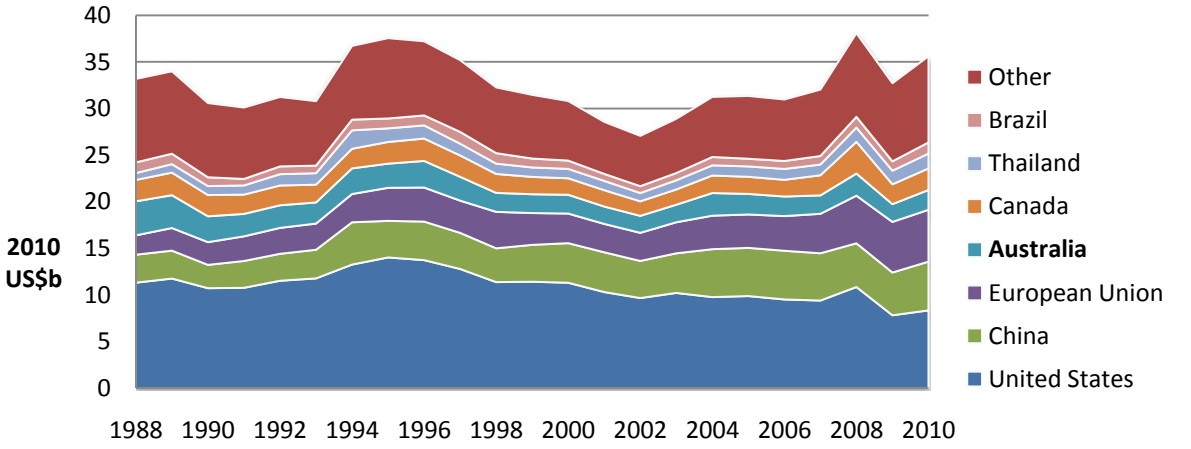
Since the early 1990s, the rates of both economic and population growth have declined. Japan's population levels are now, slightly, in decline. Combined, the low rates of economic and population growth have contributed to a flattening out in aggregate demand for food in Japan.

VALUE OF AGRICULTURAL, FISHERIES AND FORESTRY GOODS IMPORTS AND EXPORTS, BY COUNTRY

Japanese agricultural imports

Japan is the world's largest net importer of agricultural products. Australia is Japan's fifth largest source of imported agricultural products and Japan is Australia's largest export market for agricultural products. Major exports include beef, cereal residues (for example starch), dairy products, wheat, sugar and barley.

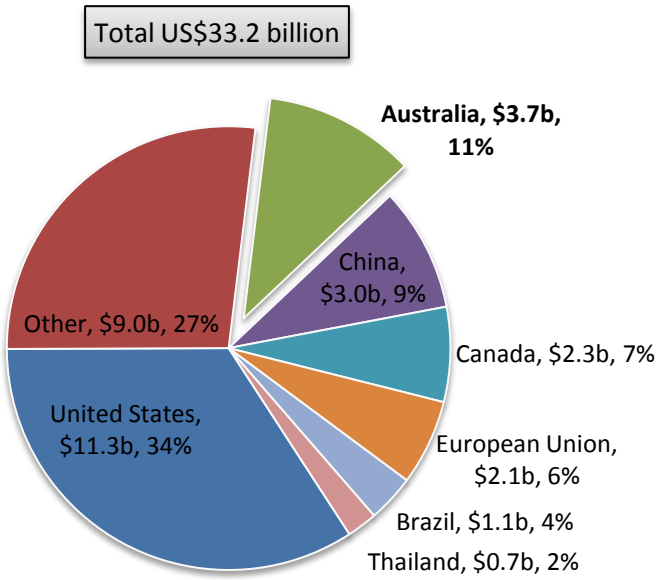
Figure 1 Japanese agricultural imports, by country



Values in 2010 US$ billions. Source: Comtrade

In 1988, Japan's total agricultural imports were worth US$18.25 billion or US$33.2 billion in 2009-10 US dollar terms (Figure 2). At this time, Australia was Japan's second largest import source, with an 11 per cent market share worth US$3.7 billion.

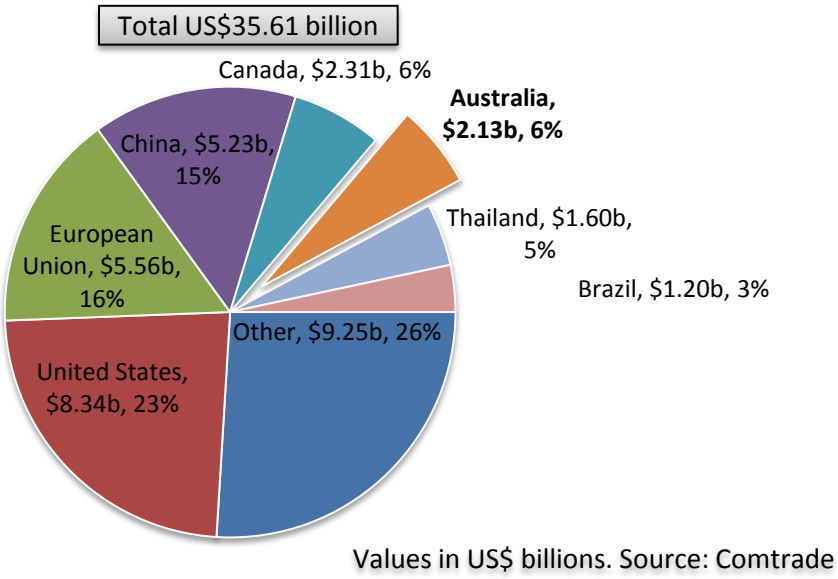
Figure 2 Japanese agricultural imports, by country, 1988



Values in 2010 US$ billions. Source: Comtrade

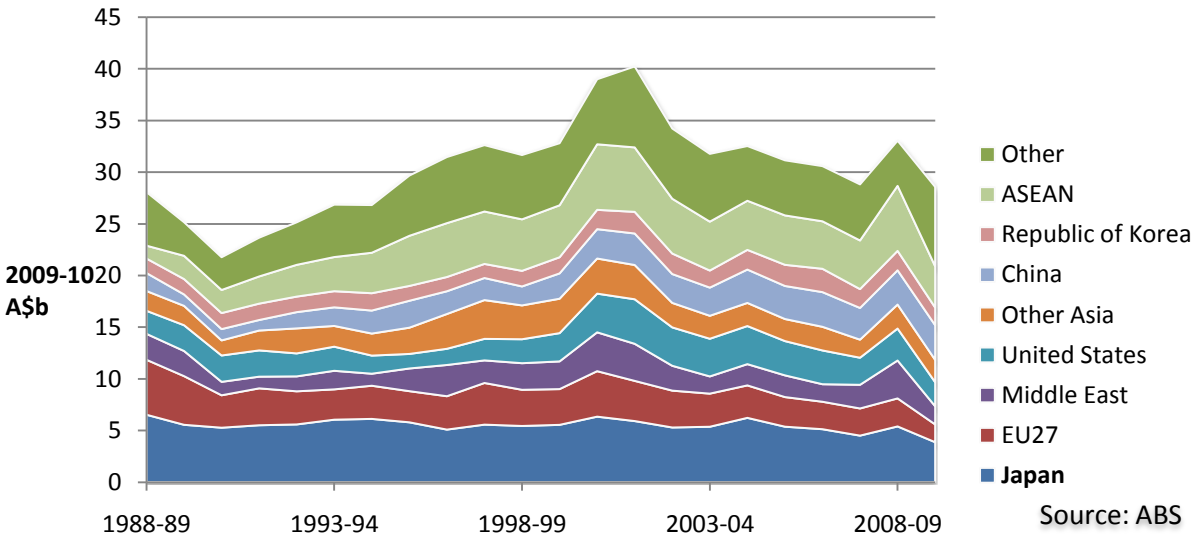
In 2010, Japan's import market for agricultural products was worth US$35.6 billion (Figure 3). The United States has remained Japan's largest source for agricultural imports, with a market share of 23 per cent, a decline from its 34 per cent share in 1988. In 2010, Australia had a 6 per cent market share of Japan's agricultural import market, down from its 11 per cent share in 1988. In 2010, Australia was Japan's fifth largest agricultural supplier, behind the United States, the European Union, China and Canada.

Figure 3 Japanese agricultural imports, by country, 2010



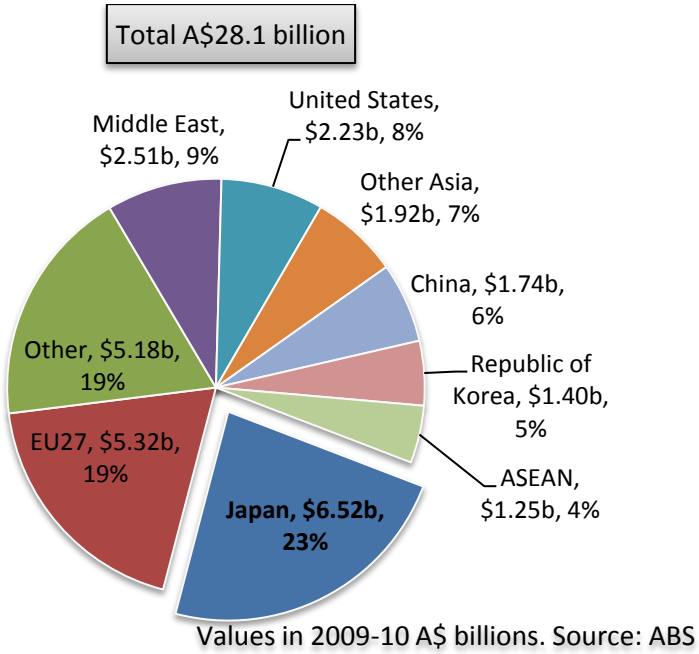
Australia's agriculture sector is highly export-oriented with a large proportion by value of farm production exported every year. Over time, the countries with which Australia trades has evolved (Figure 4). Some markets, including those in Europe and North America, have declined in importance while demand has increased for Australia's farm exports from countries in the nearby Asia region.

Figure 4 Value of Australian agricultural exports, by country



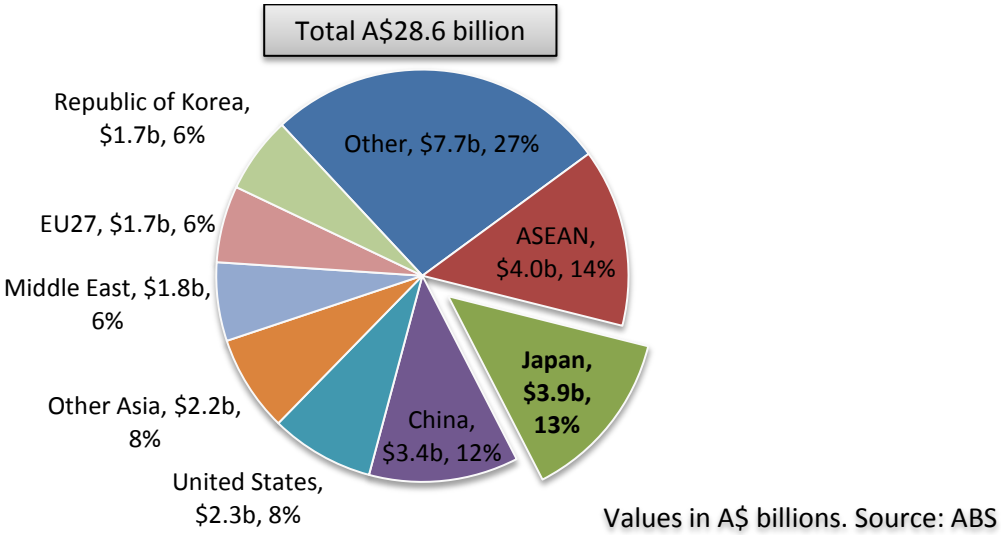
The Australian agricultural sector has placed great importance in Japan as a market for its exports. In 1988-89, Japan was Australia's largest export market for agricultural products, with agricultural exports worth A$3.5 billion (around A$6.5 billion in 2009-10 dollars) or around 23 per cent of Australia's agricultural exports (Figure 5).

Figure 5 Value of Australian agricultural exports, by country, 1988-89



In 2009-10, Japan continued as Australia's largest single market for agricultural exports, however, its standing has declined in both relative and absolute terms as Australia has diversified its export markets (Figure 6).

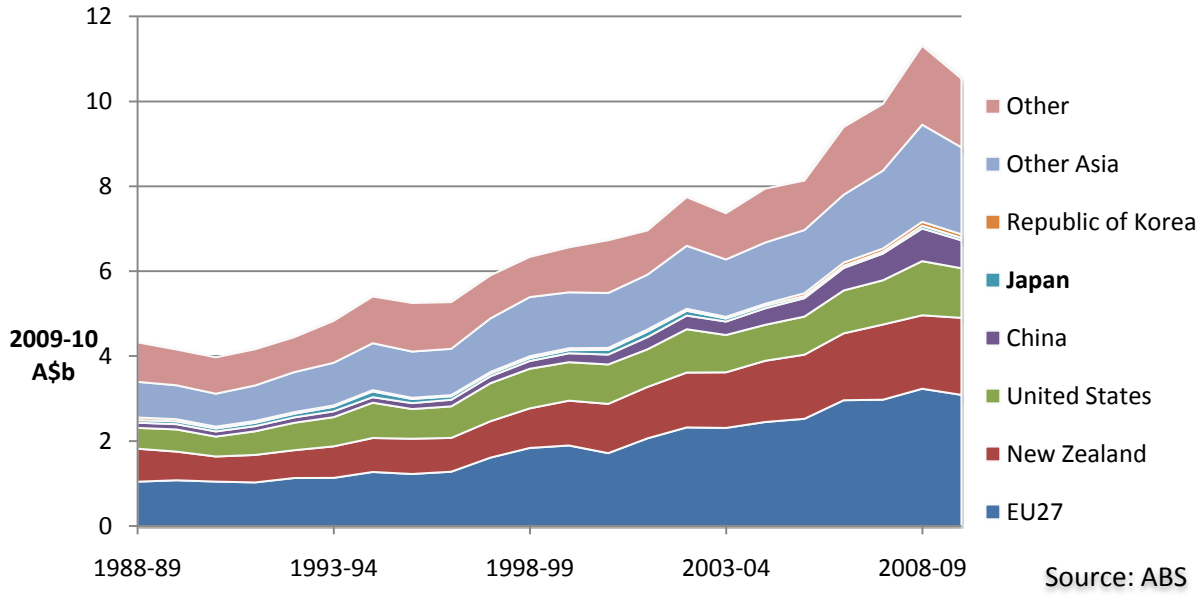
Figure 6 Value of Australian agricultural exports, by country, 2009-10



Australian agricultural imports

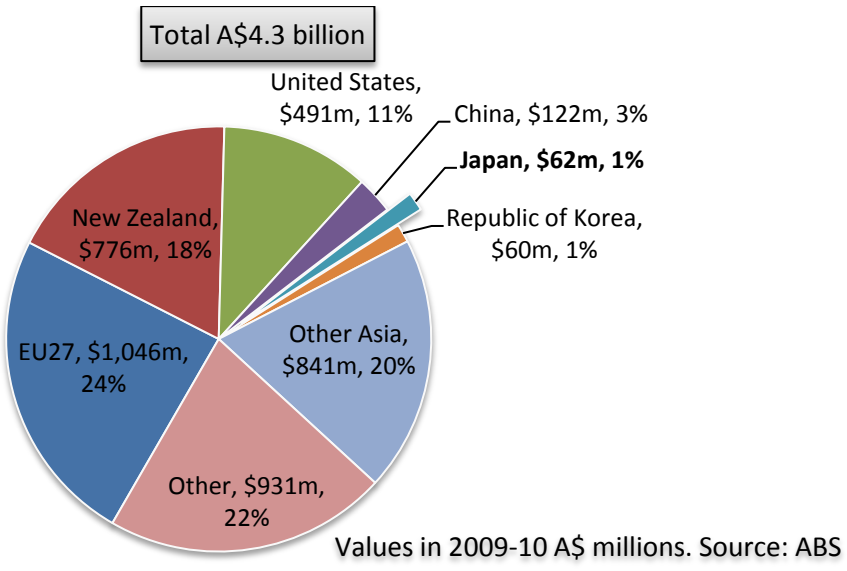
Although Australian agricultural and food imports are substantial, being valued in 2009-10 at around one-third of Australia's agricultural exports, agricultural and food products from Japan have never been a significant part of Australia's agricultural import picture (Figure 7).

Figure 7 Value of Australian agricultural imports, by country



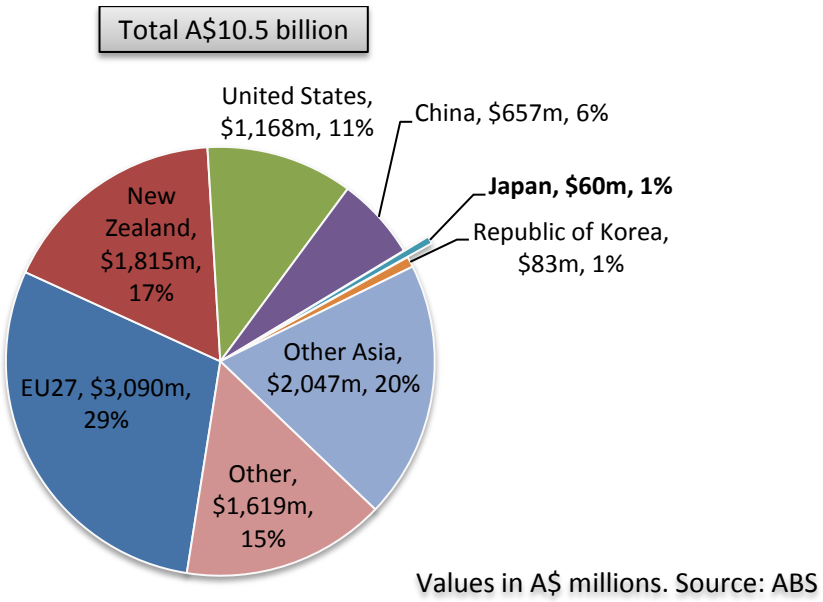
In 1988-89, Australian imports of Japanese agricultural and food products were small – valued at around A$33 million, accounting for around 1 per cent of Australia's agricultural import market. In contrast, at that time, imports of agricultural products from the European Union were valued at A$563 million, giving the European Union a 24 per cent share of Australia's agricultural import market (Figure 8).

Figure 8 Australian agricultural imports, by country, 1988-89



In 2009-10, Japan remained a small supplier of agricultural and food products to the Australian market. In that year, Japanese agricultural imports to Australia were valued at A$60 million, around 1 per cent of Australia's agricultural import market. The European Union remained Australia's largest source for imported agricultural products, with imports valued at in excess of A$3 billion, giving the European Union a 29 per cent share of Australia's agricultural import market (Figure 9).

Figure 9 Australian agricultural imports, by country, 2009-10

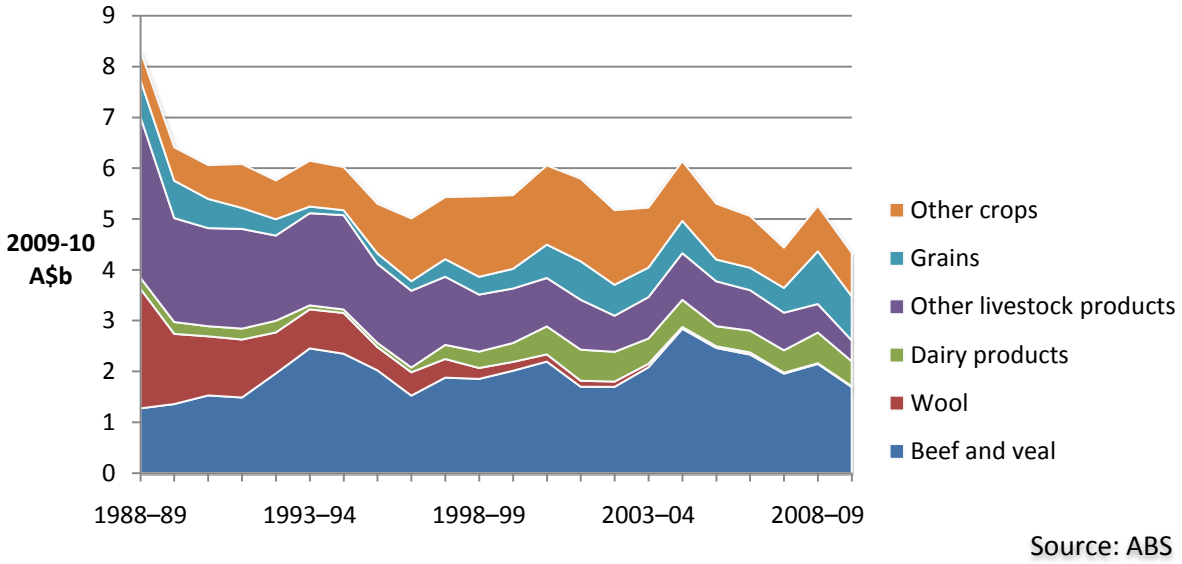


COMPOSITION OF AUSTRALIA'S TWO-WAY AGRICULTURAL, FISHERIES AND FORESTRY TRADE WITH JAPAN

Composition of Australian agricultural exports to Japan

The value of Australian agricultural exports to Japan has remained relatively constant in real terms since the late 1980s. However the composition of that trade has changed considerably (Figure 10). The importance of livestock products, other than meat and dairy, has declined. For example, Japan was Australia's premier market for wool, trade in wool between Australia and Japan is now a fraction of historical levels. In that time however, exports of beef and veal have increased, as have exports of dairy products. Grain and other crop products including sugar, have increased too. Australia's agricultural and food imports from Japan mainly comprise processed specialty foods, including seaweed products and sauces.

Figure 10 Composition of Australian agricultural exports to Japan



Source: ABS

BSE in North America and Australia's beef exports to Japan

Over much of the past decade, Australia's beef exports to Japan have been supported by Australia's status as being free from major livestock diseases that have interrupted other markets, including those that have also supplied the Japanese market. For example, outbreaks of 'mad cow disease' or bovine spongiform encephalopathy (BSE) in Canada and the United States in 2003 lead to their market access to Japan being suspended. Historically, Australia and the United States have been the dominant suppliers of beef and veal to Japan.

The exclusion of North American competitors from the Japanese market due to BSE resulted in increases in the value of Australian exports of beef of 81 per cent to Japan. Prior to the outbreak of BSE in North America, on a value basis, Australia's exports of beef to Japan were worth A$1,238 million in 2002. At the peak following the closure of those markets to North American suppliers, the value of Australian exports was A$2,245 million (2005) for Japan. This is a A$1 billion increase for the Japanese market.

More recently, both Canada and the United States have, at least partially, regained access to the Japanese market. The re-entry of these competitors is expected to place downwards pressure on Australian beef exports to Japan.

Table 2 Composition of Australian fisheries trade with Japan, 2009-10

	A$ million
Top fisheries exports	
Tuna – whole	112.3
Pearls	46.8
Prawns	31.4
Rock lobster	28.7
Abalone	21.7
Total fisheries exports	265.3
Top fisheries imports	
Scallops	9.5
Fish – prepared or preserved	2.1
Pearls	1.3
Whole prawns – frozen	0.7
Total fisheries imports	18.5

Composition of Australian fisheries exports to Japan

Japan is a premium market for Australian seafood. It is the world's largest market for the much sought-after Southern Bluefin Tuna, which is also Australia's dominant Australian seafood export to Japan. The tuna is sourced both from sea pens near Port Lincoln in South Australia, and from Australian state and Commonwealth managed fisheries, and the high seas, in accordance with globally agreed catch limits.

Australia's seafood exports to Japan were valued at A$265.3 million in 2009-10, however seafood exports to Japan, in value terms, have declined almost 70 per cent over the past decade.

Australia's seafood imports from Japan are more modest, with small volumes lead by scallops and prepared seafood products totalling A$18.5 million in 2009-10 (Table 2).

Table 3 Composition of Australian forestry trade with Japan, 2009-10

	A$ million
Top forestry exports	
Woodchips	756.7
Sawnwood	5.3
Paper & paperboard	4.6
Wood-based panels	4.0
Railway sleepers	1.6
Total forestry exports	774.4
Top forestry imports	
Paper and paperboard	76.7
Printing & writing paper, paperboard	5.2
Self-adhesive paper & p/board	5.1
Paper, paperboard, cellulose wadding	4.7
Bleached kraft paper and paperboard	3.2
Total forestry imports	105.7

Composition of Australian forestry exports to Japan

Australia's major forest product export is wood chips and Japan is a major market. Australia exported A$756.7 million of woodchips (or 88 per cent of Australia's total woodchip exports) to Japan in 2009-10. Japan is a relatively minor export market for other forestry products.

However, Japan is a significant supplier of paper and paperboard, valued at A$76.7 million in 2009-10. A range of other paper products constituted the remainder of Japan's forestry exports to Australia, bringing total imports to A$105.7 million in 2009-10 (Table 3).

VALUE OF AGRICULTURAL, FISHERIES AND FORESTRY SERVICES IMPORTS AND EXPORTS, BY COUNTRY

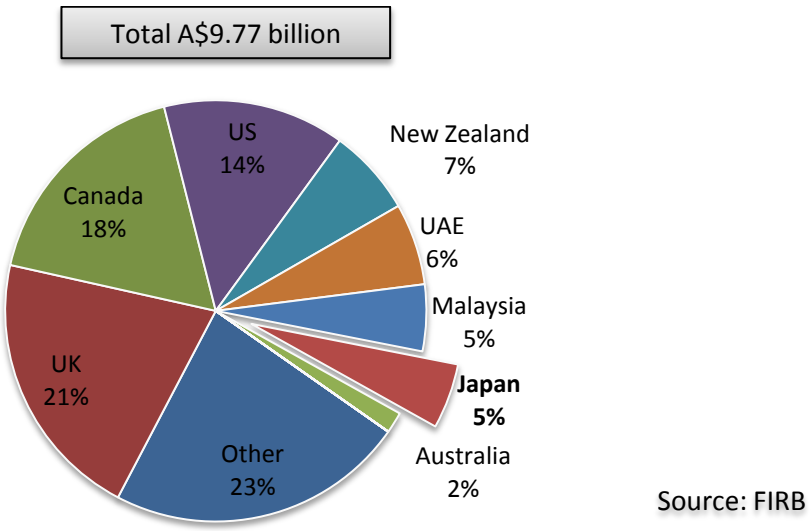
Two-way trade in services related to agriculture, fisheries and forestry is understood to be small. Japan's services market is generally closed to foreign competition, particularly in agriculture.

VALUE OF AGRICULTURAL, FISHERIES AND FORESTRY INVESTMENTS WITH JAPAN

With its large, competitive agricultural, fisheries and forestry sectors, Australia is an attractive foreign investment proposition for many countries, including Japan.

Over the ten years to 2009-10, Japan was Australia's seventh largest proponent of foreign investments in Australian agriculture, fisheries and forestry that were subject to the approval process of the Foreign Investment Review Board (FIRB)[4], with investments over the period of A$489 million (Figure 11). Most of Japan's investments in Australian agriculture over the ten years to 2009-10 occurred in 2008-09 ($238m) and 2009-10($150m). The United Kingdom was the largest such investor in Australian agriculture, with investments during the ten years leading to 2009-10, totalling A$2,032 million.

Figure 11 Foreign investment proposals subject to FIRB review in Australian agriculture, fisheries and forestry, by country, 2000-01 – 2009-10



Japan's agricultural, fisheries and forestry sector is substantially off-limits for foreign direct investment (FDI). The OECD publishes an index of foreign direct investment restrictiveness[5], with a score of 1 indicating a closed posture to foreign direct investment, and a score of 0 indicating a fully open posture to foreign direct investment. In 2010, the OECD assessed Japan's agriculture, fisheries and forestry sectors as having FDI restrictiveness scores of 1. In contrast, Australia's agriculture, fisheries and forestry FDI restrictiveness scores are each 0.1.

DAFF is currently undertaking a study into levels of foreign investment in Australian agriculture.

[4] Investment data specific to agriculture is available only as published by the Foreign Investment Review Board (FIRB). The statistics published by the FIRB relate only to those proposed investments that fall within the scope of the *Foreign Acquisitions and Takeovers Act 1975* and Australia's Foreign Investment Policy, and therefore are not a measure of actual or total foreign investment.

[5] Blanka Kalinova, Angel Palerm and Stephen Thomsen (2010), "OECD's FDI Restrictiveness Index: 2010 Update", *OECD Working Papers on International Investment, No. 2010/3*, OECD Investment Division, www.oecd.org/daf/investment

EMERGING AND POSSIBLE FUTURE TRENDS IN THESE RELATIONS

DOMESTIC FACTORS AND FUTURE TRENDS INFLUENCING AUSTRALIAN AGRICULTURE, FISHERIES AND FORESTRY

DEMAND-SIDE FACTORS

Australia is considered a mature market for agricultural products with relatively high per capita consumption by world standards. In most countries, population and income growth are the main driving factors of the growth in domestic consumption. The difference is that food accounts for a considerably smaller proportion of expenditure in Australia compared with countries in our region. Australia is a major net exporter of agricultural products with most of its agricultural industries being export orientated.

Total consumption of agricultural products (for example, meat, grains and, dairy products) in Australia has risen with population and income growth. Australia's population and per capita income has been growing at an average rate of 1.3 per cent and 2 per cent a year, respectively, between 1990 and 2010. In the four years to 2010, population growth accelerated with higher immigration. These factors are contributing to increasing aggregate demand for food, some of which will be supplied domestically, and some of which—particularly of processed foods—will be sourced from overseas.

Higher consumption of agricultural products that are used as inputs, such as feed grains, particularly in the expanding poultry industry, has also contributed to the increase in total agricultural consumption in Australia. In addition, recurrent drought over the past decade has resulted in higher feed grain consumption by the beef cattle and dairy industries as pasture growth was affected by the adverse seasonal conditions.

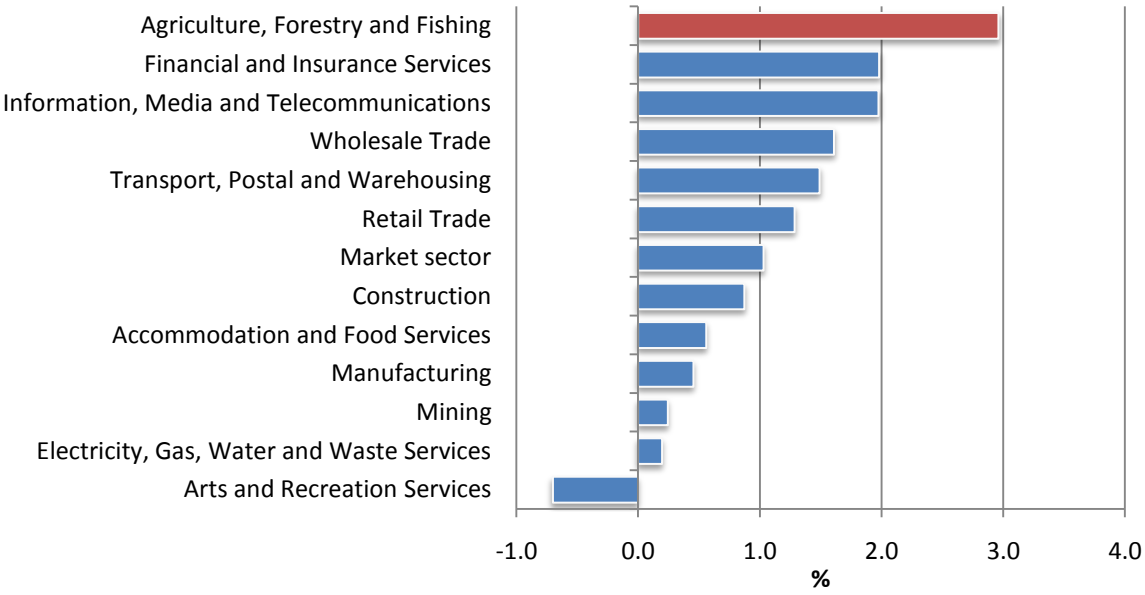
PRODUCTIVITY CHALLENGES

Australia's agriculture sector has achieved substantial productivity gains over the past two decades, exceeding most other sectors of the market economy (Figure 12). This productivity growth has offset a decline in farmer's terms of trade, which has averaged around 1.2 per cent annually (between 1985-86 and 2009–10).

Given their reliance on global commodity markets, Australian producers rely on productivity growth to maintain and improve their international competitiveness.

While comparisons of agricultural productivity between countries are difficult, Australia's productivity performance compares favourably with many other developed countries, including the United States and the OECD average.

Figure 12 Industry productivity trends, 1985-86 - 2009-10 (annual average growth %)[6]



Source: ABS data (2010)

Governments play a key role in creating an operating environment that is conducive to productivity growth. Within the policy mix, strategies to increase Australia's agricultural productivity will continue to be pursued through investment in research and development, the promotion of competition and efforts to enhance farm resilience, self-reliance and adaptability. These efforts at home are complemented by efforts to liberalise and gain improved access to agricultural markets—multilaterally, regionally and bilaterally.

NATURAL RESOURCE CHALLENGES

Australia has several natural challenges that limit Australia's ability to increase its agricultural output and thereby increase its supply of agricultural products to overseas markets, including Japan. These include sustainable land use challenges, climate change and water availability.

The sustainable use of land and appropriate management of natural resources underpins Australia's agricultural food, fisheries and forestry industries. Intensive land uses, such as mining and urban development, involve the greatest level of modification and thus generally have the greatest environmental impact affecting the availability of land for agriculture.

Water is a resource that plays an integral role in all aspects of agriculture. The availability of water in sufficient volumes and of suitable quality is key to agricultural productivity, and this availability is subject increasingly to the vagaries of climate variability and climate change, legacies of water resource over allocation and the intense consumptive use of water from rural and urban development. Water quality is affected by environmental derived contaminants such as salinity, and human activities such as urbanisation and mining.

[6] This data series uses the Value Added (GVA) approach to estimate multifactor productivity, which excludes intermediate inputs (such as fuel, fertiliser and contract services). Productivity growth rates (for all industries) are likely to be higher than when all inputs are considered.

DOMESTIC FACTORS AND FUTURE TRENDS INFLUENCING JAPANESE AGRICULTURE, FISHERIES AND FORESTRY

DEMAND-SIDE FACTORS

Like Australia, Japan is also considered a mature market for agricultural products. Japan too has high per capital incomes, although its population is in slight decline, falling by around 0.1 per cent each year recently[7]. These factors suggest that, for the time being, aggregate demand for food (inclusive of domestic and overseas-sourced food) will be steady.

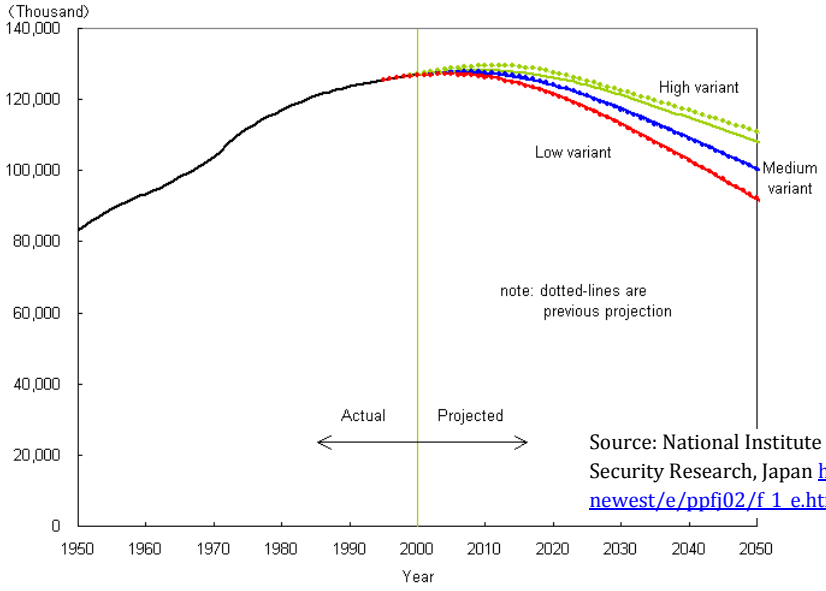
Demographic change

Japan is undergoing profound changes because of its aging population. Agriculture is affected in a number of ways. The farm workforce is aging rapidly, forcing adjustment in Japan's small-scale farm structure. Japan's rural areas in general are aging faster than the cities, and the population declined in most of Japan's prefectures during the 1990s and 2000s, affecting rural communities that have supported farm households in the past[8].

Japan's population is estimated to have peaked in 2007, with a population of around 127.8 million people[9]. By 2050, the National Institute of Population and Social Security Research projects that Japan's population may decline to around 100.6 million people[10] (Figure 13). Should Japan's population decline as substantially as projected, aggregate demand for food could contract.

[7] World Bank *World Development Indicators* http://data.worldbank.org/indicator/SP.POP.GROW accessed 7 July 2011.
[8] United States Department of Agriculture, Economic Research Service, *Japan Briefing*, http://www.ers.usda.gov/Briefing/Japan/issuesandanalysis.htm#demographic accessed on 7 July 2011.
[9] World Bank *World Development Indicators http://data.worldbank.org/indicator/SP.POP.TOTL accessed 7 July 2011.*
[10] National Institute of Population and Social Security Research, *Population Projections for Japan: 2001-2050*, downloaded from http://www.ipss.go.jp/pp-newest/e/ppfj02/top.html on 7 July 2011.

Figure 13 Japanese population: actual and projection: 1950 to 2050



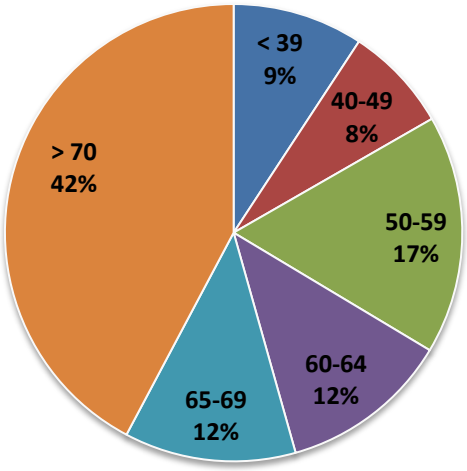
Source: National Institute of Population and Social Security Research, Japan http://www.ipss.go.jp/pp-newest/e/ppfj02/f_1_e.html, accessed on 7 July 2011.

Without policy intervention, such as a change to immigration settings or new programs to lift Japan's fertility rate, Japan's population seems likely to decline. Should this occur, compounded by the smaller dietary intakes of an older population, it would be reasonable to anticipate a contraction in aggregate demand for food in Japan. However, it may not necessarily follow that Japan's *import* demand for food will contract. Liberalisation of Japan's agricultural trade policies will go some way to improving access to countries that export to Japan. Broader reforms to Japanese agriculture will also support a continuing, long-term agricultural trading relationship with Japan.

In 2004, 25 per cent of Japan's farmers were estimated to be aged over 70 years, and 46 per cent were estimated to be aged 60 years or older. In the short period since, the age challenge facing Japanese agriculture has become more significant. The Japanese Ministry of Agriculture, Forestry and Fisheries' latest estimates, for 2009, indicate that 42.2 per cent of farm households are aged 70 years or greater and 66.4 per cent were aged 60 years or greater (Figure 14).

Put simply, Japan's farmer population is contracting. The institutional arrangements and policy settings that underpin current-day agriculutre in Japan must take into account the need to do more to attract new farmers and encourage existing players to act with sufficient responsiveness, flexibility and innovation to face new challenges.

Figure 14 Age distribution of Japanese farmers in 2009



Source: MAFF

The Tōhoku earthquake and tsunami

The earthquake and tsunami disasters of 11 March 2011 inflicted massive damage and a terrible human toll on Japan. The long-term impacts of the disasters on Japanese agriculture are beginning to emerge. Japanese agriculture will recover, however Japan continues to confront difficult choices including how to help agriculture recover and deal with the challenges it currently confronts.

The affected regions account for around 8 per cent of Japan's agricultural production, including 13 per cent of Japanese rice production and around 5 per cent of fruit and vegetable production. The affected coastline accounts for around 11.7 per cent of Japan's fisheries production. Japan's Ministry of Agriculture, Forestry and Fisheries estimates the cost of the disaster on portfolio industries to be around 2.2 trillion yen (A$22.4 billion).

Australia's agricultural exports are continuing much as before. Ports outside of the affected area are operating normally, allowing Australia's agricultural exports to continue to reach Japan. Within Japan, radionuclide contamination concerns are associated with the damaged Fukushima Dai-ichi Power Station. There is some evidence that consumers are varying normal consumption patterns with a view to avoiding perceived food safety risks associated with some fresh produce. These changes however have not significantly influenced normal patterns of agricultural trade with Australia.

PRODUCTIVITY CHALLENGES AND THE REFORM IMPERATIVE

As discussed on page 4, Japan's agricultural policy objectives and directions for agriculture are set down in agricultural basic laws.

The current Japanese Basic Law on Food, Agriculture and Rural Areas articulates Japan's vision for agriculture, including that it is managed in such a way as to ensure a stable food supply; achieve 'multifunctional' roles; be sustainable and contribute to the development of rural areas. It stipulates the requirement that the state 'formulates and implements comprehensive policies' and even goes so far as to articulate the responsibilities of farmers and consumers. Its formal objective is as follows:

> *Article 1*
>
> *The objective of this Law is to stabilize and improve people's lifestyle and to develop the national economy through comprehensively and systematically implementing policies on food, agriculture and rural areas by means of establishing basic principles and basic matters for realizing them and c1arifying the responsibilities of the state and local governments.*

Irrespective of the merit of the policy intent embodied in the basic law, Japan's agriculture, fisheries and forestry sector has been increasingly unable to deliver on these goals, and the Japanese Government has recognised the need to guide the sector down a different path.

To that end, the current Japanese government, led by Prime Minister Kan, outlined a vision for tackling some of Japan's most entrenched issues with his press release on 6 November 2010, and confirmed a few days later by Japan's Cabinet, of a revised Basic Policy on Comprehensive Economic Partnerships.

Japan's revised Basic Policy was a strategic, clear statement of intent by the Japanese Government to drive domestic reform, particularly in agriculture, but also in other broad areas that have and will affect Japanese economic performance including immigration and regulatory reform. Prime Minister Kan set a goal of releasing a revised Basic Policy on Agricultural Structural Reform by June 2011, with an accompanying action plan by October 2011.

Until the events of 11 March 2011, Japan's reform agenda looked to be progressing well. From that time however, the focus of the Japanese Government switched to the disaster response and recovery.

On 17 May 2011, Japan adopted new "Policy Guidelines: Towards Japan's Revitalisation" which confirmed that discussion on reform and trade liberalisation would continue but with revised timelines and particular sensitivity towards the views of those directly affected by the March 2011 disaster.

BILATERAL FACTORS AND FUTURE TRENDS INFLUENCING AUSTRALIA AND JAPAN'S AGRICULTURAL, FISHERIES AND FORESTRY RELATIONSHIP

THE UNDERPINNINGS OF THE AUSTRALIA-JAPAN AGRICULTURAL TRADING RELATIONSHIP

Australia and Japan have a close relationship, enjoying mutual benefits that span commerce, culture, science and academia, security and diplomacy. Australia's agricultural trade relationship with Japan is one important element, balancing Japan's manufacturing and technology prowess. Australia's comparative advantage in agriculture reflects its endowment of natural resources including land and climate. With its large population but small landmass, Japan's economy has been built on high technology, manufacturing and research.

THE AUSTRALIA-JAPAN FREE TRADE AGREEMENT NEGOTIATIONS

Australia and Japan agreed to enter into FTA negotiations in December 2006 and the first negotiations were held in April 2007. Since then, twelve rounds of FTA negotiations have been held. Due to the March 2011 triple disaster and its implications, the thirteenth round of negotiations has been postponed; however, government commitment to the FTA in Japan and Australia remains strong.

During their meeting in Japan in April 2011, Prime Minister Julia Gillard and Japanese Prime Minister Kan agreed to continue negotiations towards concluding a comprehensive FTA, taking into account the impacts of the earthquake and tsunami in Japan. Limited progress has been made on agriculture market access in FTA negotiations with Japan to date.

On 17 May 2011, Japan adopted new "Policy Guidelines: Towards Japan's Revitalization" which confirmed that discussion on trade liberalisation would continue but timelines will be revised.

Australian agriculture stands to benefit greatly from a comprehensive FTA that includes reductions in tariffs affecting Australia's key rural exports. Australia's producers face some steep tariff barriers along with tariff-like arrangements, and for some commodities must navigate complex statutory marketing systems, all of which combine to stand between them and Japanese consumers.

Examples of current tariffs on some of Australia's major agricultural export interests include: beef (38.5-50 per cent); dairy (21.3-350 per cent); refined sugar (107.5 Yen/kg or approximately AU$1.30/ kg); and oranges (16-30 per cent).

A noteworthy aspect of Japan's previous agreements is that, with a small number of exceptions, no substantial concessions on agriculture have been made in preceding agreements with other countries. These include Peru, India, Thailand, Singapore, Philippines, Malaysia, Mexico, Chile, Indonesia, Vietnam, ASEAN, Switzerland and Brunei. Nevertheless, Australia's position has been clear and consistent, and an agreement with Japan must include commercially meaningful outcomes on Australia's agricultural interests.

COOPERATION IN AGRICULTURE

Australia, through the Department of Agriculture, Fisheries and Forestry, actively engages with Japan in a spirit of cooperation. The department regularly hosts delegations from Japan, who are often in Australia to inquire or investigate Australian approaches to issues of mutual interest. Many of these engagements are at an officials level relating to technical aspects of biosecurity and more recently policy driving future agriculture production.

Looking forward, there is scope to do much more. In a situation where Japan introduces reforms to its agriculture sector that demand higher levels of innovation and new efficiencies, Australia's experience will be relevant, and cooperation in both the public and private sectors could be expected to increase. Of interest to Australia will also be the opportunity to begin to benefit from the opportunities in Japan to cooperate commercially and collaboratively in the provision of advice and services to Japanese agriculture.

Australia and Japan cooperate in annual government and industry dairy, beef and plant health talks, hosted alternately by both countries. The beef and dairy talks address current and

projected world supply and demand conditions, as well as specific factors that have influenced supply and demand in Australia and Japan over the past year. The talks provide an important forum for both countries to exchange views, outside formal trade negotiations, on global and bilateral issues affecting the trade. In the past these issues have included both tariff and non-tariff barriers to trade, measures to increase demand for beef and dairy in both countries, and environmental issues.

COOPERATION IN FISHERIES MANAGEMENT

Japan is a distant-water fishing nation that is very active in the Regional Fisheries Management Organisations of which Australia is a member: The Commission for the Conservation of Southern Bluefin Tuna; the Western and Central Pacific Fisheries Commission; and the Indian Ocean Tuna Commission. In these organisations, Australia aims to cooperate with Japan to agree to measures that are consistent with the interests of coastal States and will achieve sustainability of the fish stocks managed by each organisation. Often, member countries' views and approaches are quite different, which can lead to difficulties in obtaining agreement.

Issues in relation to the management of southern bluefin tuna stocks are particularly important to Australia. The Australian southern bluefin tuna industry is based in Port Lincoln, South Australia. Industry catches juvenile southern bluefin tuna in the Great Australian Bight and then tows these fish back to Port Lincoln where they are fattened over several months and then harvested for export, almost exclusively to the Japanese market. The global level of catch of southern bluefin tuna and national shares for each member are allocated by the Commission for the Conservation of Southern Bluefin Tuna.

GLOBAL FACTORS INFLUENCING AUSTRALIA AND JAPAN'S AGRICULTURAL, FISHERIES AND FORESTRY RELATIONSHIP

MULTILATERAL TRADE ARRANGEMENTS

Japan and Australia are both active members in the multilateral fora including the World Trade Organization (WTO), the G20, the Food and Agriculture Organization (FAO) and the Organization for Economic Co-operation and Development (OECD).

Within these international bodies, Australia's engagement with Japan is more prominent in the WTO, and to a lesser extent in the OECD. On agricultural trade issues, we do not generally hold the same views, particularly over agriculture support and increased market access, but in other areas such as services and industrial products, we share similar perspectives. However, there is an open and frank exchange of views on agricultural issues between the two countries. Both Australia and Japan have commitments with respect to agricultural support and market access as a result of their membership of the WTO. Both countries are strong advocates of the multilateral trading system and we share a close engagement in Geneva. The WTO provides a forum for Australia to seek information on Japan's agricultural policies and if necessary raise any concerns with respect to these policies. Likewise, Japan is able to seek information on Australian policies and raise any concerns.

Both Australia and Japan are committed to concluding the WTO Doha Round of trade negotiations. Even if there is no conclusion to the Round in the short-term Australia and Japan will continue to engage on agricultural issues through the WTO.

In the FAO, Japan and Australia have been strong supporters of FAO reform and have pushed for greater effectiveness and efficiency across the organisation. Japan represents the Asia region on the FAO Programme Committee and, with Australia, has urged fiscal restraint in relation to the setting of the FAO budget level. At the recently concluded FAO Conference, Japan, for the first time in several biennia joined the consensus in support of an increase of 1.5 per cent on the level of member contributions, which Australia interprets as an endorsement of progress made in the reform of the FAO.

In terms of our relationship with the OECD and its committee structure Japan is a key alley in helping to balance the euro-centric nature of the OECD. We work together to ensure that issues of relevance to the region are not overlooked and remain a core area of the OECD's work program.

REGIONAL TRADE ARRANGEMENTS

Trans Pacific Partnership Agreement (TPP)

While Japan is not currently a TPP negotiating party, it is envisaged the TPP could grow over time into an Asia Pacific-wide agreement. The Japanese Government had actively expressed interest in joining the TPP, but this interest has more recently been tempered because of the earthquake and tsunami. However, Japan can apply to join the TPP once the agreement is established and it is in a better position to devote resources to the agreement. Decisions on admitting new members to the TPP are taken jointly by TPP parties on a consensus basis. TPP parties have agreed that any country that seeks to join the TPP needs to demonstrate willingness to commit to a high-quality and comprehensive agreement.

BILATERAL TRADE ARRANGEMENTS WITH THIRD COUNTRIES

Japan has been pursuing for some time free trade agreements with countries around the world (see the Australia-Japan Free Trade Agreement discussion on page 21). These *Economic Partnership Agreements (EPAs)* as Japan refers to them, have drawn some criticism from Members of the WTO for not promoting liberalisation in agricultural trade in the same way that these agreements have done for other sectors.

BARRIERS AND IMPEDIMENTS TO TRADE AND INVESTMENT WITH JAPAN FOR AUSTRALIAN BUSINESSES

TRADE POLICIES IN JAPAN AFFECTING AGRICULTURAL TRADE WITH AUSTRALIA

Japan has a very protectionist agricultural trade policy and implements measures to protect and support its agricultural producers including producer quotas, income stabilisation measures, deficiency payments and a rice diversion program. In addition, Japan imposes high tariffs and protects its most sensitive industries – rice and dairy with tariff rate quotas (TRQs). Japanese arguments against liberalising trade in agricultural products as part of an FTA with Australia typically include assertions that Australia's agricultural sector will undercut and overwhelm Japanese producers. In reality, given the nature, including the counter-seasonality, of Australia's farm production, improved access to Japan's market will improve Australia's ability to compete against other, third country exporters to that market, including the United States and the countries of the European Union.

SPECIFIC MEASURES

The Department of Agriculture, Fisheries and Forestry refers the Sub-Committee to the submission on Japan provided jointly by the Department of Foreign Affairs and Trade and Austrade for a detailed discussion of the specific trade measures that Japan has implemented. These include high ad valorem and specific tariffs, import quotas, tariff-like duties and complicated trading arrangements, often implemented by state trading enterprises such as Japan's Agriculture and Livestock Industries Corporation, which intervenes in the market to restrict imports, lift domestic prices and to manage supply.

TECHNICAL MARKET ACCESS

Technical market access includes government technical regulations and standards and industry standards for goods that can affect international trade. These requirements are covered by the WTO Sanitary and Phytosanitary (SPS) Agreement for measures applied to protect human, animal and plant health from pests and diseases, additives, toxins and contaminants in foods and feedstuffs; and the WTO Technical Barriers to Trade (TBT) Agreement dealing with procedures for testing and certifying conformity to technical regulations (compulsory) and standards (voluntary) governing international trade.

Japanese consumers demand and are often willing to pay a higher price for food that is safe and of high quality. In response, the Japanese government has moved to strengthen consumer information about food through food labeling and to provide assurances through food safety monitoring.

Food additives and food labeling

A Food Safety Basic Law was implemented in July 2003 setting out principles of Japan's food safety policy and establishing a Food Safety Commission (FSC) to perform independent risk assessments. The Commission conducts scientific risk assessments of food then makes

recommendations to relevant ministries; and responds to food-borne accidents and emergencies.

Japan's food labeling policies have been strengthened over the last decade. The Food Sanitation Law and the Law Concerning Standardisation and Proper Labeling of Agricultural, Forestry and Fishery products provide the regulatory underpinning for food labeling including labeling for foods derived from genetically modified organisms, foods containing allergens, country of origin labeling and organic foods.

Japan's Ministry of Health, Labor and Welfare (MHLW) maintains a permitted food additives list as part of its regulatory framework for food. Australia has a cooperative working relationship with MHLW on its proposals to remove food additives from the list. This provides Australia with an opportunity to engage with industry to assess impacts and submit technical comments in support of additives used in the manufacture of Australian food products that may be exported to Japan, to minimize potential trade disruption.

Technical market access requests

Technical market access issues can be complex. Countries trading in goods subject to such technical requirements, including Australia and Japan, negotiate official protocols that serve to provide clarity and certainty about how an exporting country can comply with an importing country's requirements, and which outline each country's responsibilities. Gaining market access to Japan for agricultural products involves a formal request by Australia, an exchange of information and a detailed risk analysis by the relevant Japanese Government agencies.

Overall, Japan and Australia are making good progress on the other's priority market access requests for new or improved access. Australia is seeking new or improved access to Japan for table grapes and poultry and pig meat and bone meal and poultry digest. Japan is seeking the permanent movement of horses, and peach and nectarine market access to Australia.

Annual bilateral plant quarantine and animal health technical meetings, attended by senior officials, provide a useful forum to build the bilateral relationship and progress market access issues.

Recent examples of success for Australia include gaining access for non-fumigated Tasmanian cherries and improved access for meat by-products (including pet food), honeybees and all varieties of grapefruit.

Australia granted access for Japanese unshu mandarins in August 2009 and since mid-2010, horses from Japan can again be temporarily imported for the first time since the 2007 equine influenza outbreak.

SANITARY AND PHYTOSANITARY CONSIDERATIONS AFFECTING BILATERAL TRADE

Japan generally notifies changes to its import requirements to the World Trade Organisation Sanitary and Phytosanitary Committee. Australia provides comments on these notifications as required.

Australia's meat and meat product exports to Japan

Japan is Australia's largest export market for meat and meat products in value and volume terms. Beef was the dominant export product in 2009-10, ($1.7 billion), followed by lamb ($63 million), mutton ($27 million) and pork ($1.8 million) for the same period.

The department has a strong working relationship with the Japanese government, and there are well-developed lines of direct communication for meat market access issues through the department's Minister-Counsellor (Agriculture) and Counsellor (Agriculture) in Tokyo.

Australia has had a history of successful exports to Japan and ongoing access is essential for Australia's meat industry. Australia has agreed access with Japan for the export of meat and meat products from a range of livestock species. The department has well developed auditable systems to support the food safety and traceability requirements of the Japanese market.

Japan routinely conducts audits of Australia's meat export system and has indicated confidence in the Australian system, due to its high level of assurance for product integrity.

Australian Export Meat Inspection System (AEMIS)
Australia is improving its export meat inspection system by scientifically addressing contemporary food safety hazards, particularly those hazards resulting from microbiological contamination of meat. The Australian Quarantine and Inspection Service (AQIS) has kept Japan informed of the changes.

Australia's dairy exports to Japan

Japanese authorities are familiar with, and accept Australia's export inspection and certification system for dairy products exported to Japan and the market is generally not problematic.

AQIS certifies all exports to Japan of Australian dairy products for human consumption, and some dairy pet food and stockfeed.

Chemical residue standards

The Japanese Ministry of Heath, Labor and Welfare revised the Food Sanitation Law in May 2006 to establish a positive list system for the regulation of residues of pesticides and veterinary chemicals in locally produced and imported food. Australia and Japan have cooperated closely on Japan's positive list with Australia providing technical data on over 240 chemicals in support of Australia's maximum residue limits (MRLs) for pesticides and veterinary chemicals. The aim of this cooperation is to encourage Japan to set MRLs in harmony with Australian MRLs, to minimise potential disruptions to trade while supporting the goal of protecting the health and safety of its consumers. For example, the Japanese and Australian MRL for dairy products are very similar and the Australian Milk Residue Analysis (AMRA) survey provides information about the residue status of Australian milk. AMRA is Australia's national residue monitoring program for milk.

The Australian Government established the National Residue Survey (NRS) in the 1960s. The NRS is a program within DAFF that assists industry by providing risk-based residue testing services on a cost recovery basis to support market access. Industries participate in the NRS on a voluntary basis and are provided with the results of residue monitoring. Export certification is administered under the *Export Control Act 1992*. Data from NRS residue monitoring for animal

products supports export certification to meet importing countries market access requirements. Australia has no export certification requirements for residues for any plant products.

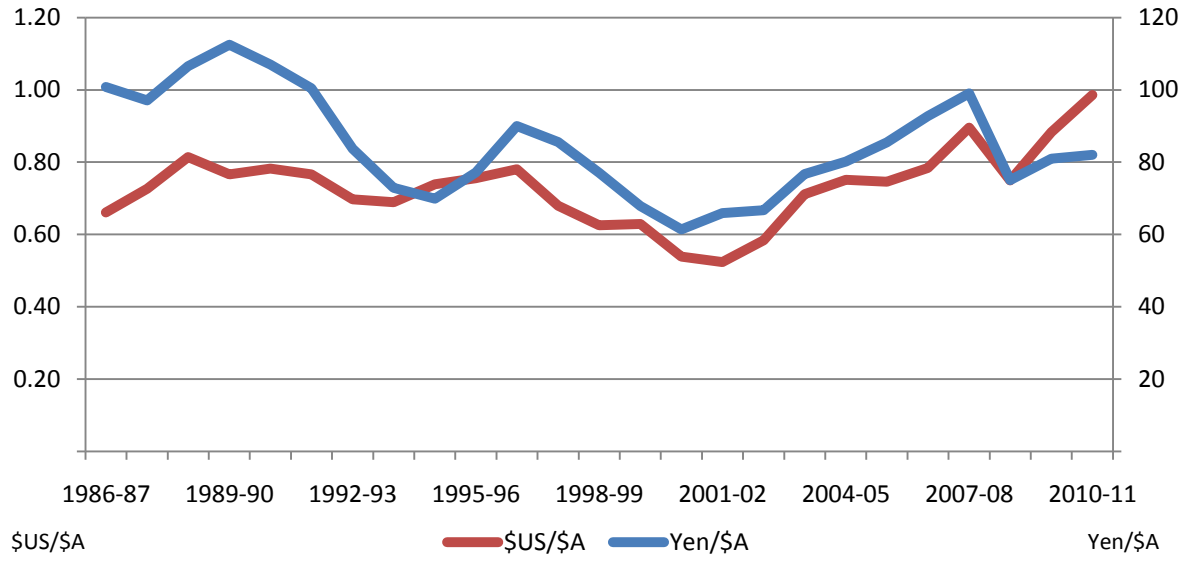
Australia's fisheries exports to Japan

Currently, trade in Australian fish and fishery products to Japan (for human consumption) occurs relatively smoothly with the primary products exported, in order of value, being tuna (whole), pearls, prawns, rock lobster and abalone. Mandated export health certification is only required by Japanese authorities for consignments of marron, red claw, yabbies, oysters, pipis and cockles.

CURRENCY MOVEMENTS

From the mid-1980s to 2000-01, the value of the Australian dollar depreciated against the Japanese yen by around 39 per cent (Figure 15). Since then the trend has reversed, with the Australian dollar appreciating by around 34 per cent to average ¥82 in 2010-11 from an average of ¥61 in 2000-01.

Figure 15 Australian, US and Japanese currencies



Looking forward, the Australian dollar is expected to appreciate against the Japanese yen over the medium term (to 2015-16). Factors underpinning this assessment include forecast strong demand for agricultural and mineral resources commodities in the world markets. While the strong commodity demand is expected to support Australian export earnings and terms of trade, the strong Australian dollar may limit Australia's agricultural exports to Japan to some extent.

OPPORTUNITIES FOR DEEPENING EXISTING COMMERCIAL LINKS, AND DEVELOPING NEW ONES, WITH JAPAN

The imperative for reform of Japan's agriculture sector was discussed earlier under the heading "Productivity challenges and the reform imperative" on page 19. Japan is under pressure to pursue reform of agriculture and has made tentative steps down that path. Aside from the domestic pressures to tackle reform, Japan is under pressure to reform its agriculture sector in the context of its engagement with FTA partners including Australia, its potential inclusion in the Trans Pacific Partnerships as well as from within the WTO.

With the pursuit of reform in Japan will come opportunities for Australian agriculture. Many institutional barriers to trade with Japan stand to be addressed if reform is taken-up, including barriers that prevent Australian exporters establishing direct commercial relationships with Japanese end-users. Opportunities may also extend to the granting of access to Japan's largely closed market for the delivery of agricultural services in Japan, and to new investment opportunities.

Other opportunities also stand to open-up, irrespective of the reform agenda. Although, as discussed earlier, Japan's population is contracting, new opportunities may arise as the composition of trade changes reflecting Japan's changing demographics.

FACILITATING COMMERCIAL RELATIONSHIPS

DAFF does not specifically work to develop new commercial linkages with Japanese counterparts to Australian firms. However, the department does have a role in supporting existing commercial relationships because of its work in technical market access. This work facilitates trade and may make possible new commercial relationships. For example, the work the department does in negotiating market access protocols, in accordance with strategic priorities established jointly by industry and government, opens doors for producers of farm products in Australia to establish new commercial relationships with counterparts in Japan. However, the department does not have a role in commercial matchmaking.

The department's work in this area is achieved through annual bilateral discussions; cooperation at the multilateral level; and high-level government-to-government /industry –to-government visits between Australia and Japan.

Australian Government

Department of Agriculture, Fisheries and Forestry

JOINT STANDING COMMITTEE ON FOREIGN AFFAIRS, DEFENCE AND TRADE
TRADE SUB-COMMITTEE

INQUIRY INTO AUSTRALIA'S TRADE AND INVESTMENT RELATIONSHIP WITH JAPAN AND THE REPUBLIC OF KOREA

SUBMISSION ON THE REPUBLIC OF KOREA

July 2011

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TABLES

FIGURES

Note: Currency values referenced to a particular year, for example, '2009-10 A$b', are 'real values', that is, they are adjusted for inflation and expressed using the value of the currency in the specified year.

FOREWORD

On 21 April 2011, the Minister for Trade, the Hon. Dr Craig Emerson MP, asked the Joint Standing Committee on Foreign Affairs, Defence and Trade (the Committee) to inquire into and report on Australia's trade and investment relationship with Japan and the Republic of Korea.

The following submission is made by the Australian Government Department of Agriculture, Fisheries and Forestry ('DAFF' or the 'Department') for the Republic of Korea (Korea) addressing the Committee's terms of reference, with particular reference to:

- *the nature of Australia's existing trade and investment relations;*
- *emerging and possible future trends in these relations;*
- *barriers and impediments to trade and investment with Japan and the Republic of Korea for Australian businesses;*
- *opportunities for deepening existing commercial links, and developing new ones, with Japan and the Republic of Korea; and*
- *the role of the government in identifying new opportunities and assisting Australian companies to access existing and potential opportunities in Japan and the Republic of Korea.*

This accompanies a separate submission also made by DAFF on Australia's trade and investment relationship with Japan.

OVERVIEW

Australia and Korea are strong economic, political and strategic partners, sharing core values and interests. Australia's relationship with Korea is growing, and is one that the Australian Government, industry and the Australian community value greatly.

Australia and Korea are regional middle-powers. They have stable governments, and dynamic, market-based economies that have demonstrated strong growth over recent years. Commercial linkages have also increased. Australia's relationship with Korea is strengthened by the differences between the countries. Australia's proficiency in agricultural production and its wealth of natural resources creates the necessary basis for trade and exchange because Korea, relatively speaking, has strengths in other areas. Korea has an emerging global presence in the manufacture of cars and other heavy industry, refinement of oil and the production of advanced technology items, and these items are strongly demanded by Australia. The Australian market for these products is increasing.

Over the past few decades Korea has undergone significant industrialisation with gross domestic product (GDP) increasing at an average rate of 4.6 per cent a year between 1990 and 2010. Economic growth in Korea expanded by 6.2 per cent in 2010[1]. This shift in Korea's economy has, in some respects, lead to Korea's agricultural sector falling behind with an increasing gap in income between those working in the agricultural sector and those working in other sectors. Arable land has decreased due to pressures from urbanisation and competition for resources. Korea also has an aging rural population as the younger generations move towards more lucrative jobs in the industrial sector. Overall, these factors have affected the Korean agriculture sector's ability to meet domestic food demand, and the progressive shift towards non-traditional foods such as dairy, wheat and beef.

Australia and Korea's trade relationship is complementary, and it has grown steadily since the 1960s when its economy began to open-up following the Korean War. Australia is one of the major agricultural exporters to Korea. Australia annually exports around 60 per cent of its agricultural farm production while Korea is a net importer of agricultural products, importing 70 per cent of food needs. The agricultural relationship has been dynamic, with agricultural and food exports to Korea expanding over the years, with the composition of trade changing also. For example, while Australia's wool exports to Korea have declined due to the relocation of processing industries to lower-cost China, exports of beef and veal have increased markedly.

There are some impediments to the Australia-Korea agricultural relationship. Korea's sensitive agricultural products, such as barley, are still protected by higher import duties than other agricultural and non-agricultural goods. Overall, Korea's agriculture policies offer a high degree of protection for Korean domestic agriculture. Measures include domestic support and subsidies, high tariffs and non-tariff barriers (for example quotas). In contrast, Australia operates an agricultural sector that is highly trade exposed.

Looking ahead, there is no expectation that the trading relationship between Australia and Korea will remain static. Australia is, and will remain, a large agricultural exporting country that

[1] ABARES, *Australian Commodities,* vol. 18 no.2, June Quarter 2011.

relies on market signals to determine destinations for exports. In Australia, there are some challenges that stand to change the way agriculture is practised, including scarce but better allocated water resources, urban-rural competition for resources and increasingly variable climate. Australia is actively managing these challenges and pursuing solutions.

The Australian Government is investing in programs to prepare farmers for the challenges presented by climate change; it is leading the combined effort to better manage the competing demands on water in the Murray Darling Basin; it is investing to improve the sustainable use of the natural resources that support farming; it is working to reform Australia' s biosecurity arrangements; it is investing—in partnership with farm industries—in research and development that contributes to increasing Australian farm productivity. Australia will remain a supplier of safe, high quality food into the future.

Korea has many challenges that confront it in agriculture. Korea's agriculture sector is defined by small-scale, highly protected farms operated by an increasingly ageing farmer population. Differently to Japan, Korea has made more progress down the path to agriculture reform achieved largely though the opening-up of much of its agriculture sector to foreign competition through free trade agreements. For example, the Korea-European Union Free Trade Agreement entered into force on 1 July 2011, which has lead to the immediate elimination of tariffs imposed on some minor agriculture products, and the progressive elimination of tariffs over a number of years on more substantial products, including one of Australia's core interests, beef.

Similarly, Korea has concluded negotiations for a free trade agreement with the United States which will, once ratified by both countries, include the phased elimination of tariffs on a number of Australia's priority agricultural exports. These developments underscore the importance of Australia concluding a free trade agreement with Korea that includes comparable tariff reductions enabling Australia to compete fairly against these large suppliers to Korea's market. Entering into a high quality and comprehensive free trade agreement will be a considerable step in sustaining Australia's close agricultural relationship with Korea.

Australia's agricultural relationship with Korea is set to continue to expand, particularly in light of a free trade agreement that the leaders of both countries aim to have concluded by the end of 2011. Australia and Korea have familiar business cultures and enjoy a high level of trust in each other. This growing depth of relationship bodes well for the future.

THE NATURE OF AUSTRALIA'S AGRICULTURAL TRADE AND INVESTMENT RELATIONSHIP

Korea is an important trading partner for Australia, not only for trade in goods but also trade in services and investment. This relationship has been developed over many years. Trade in agriculture is a key part of this picture.

THE HISTORY OF AGRICULTURAL GOODS AND SERVICES TRADE AND INVESTMENT

Since the 1960s Australia and Korea have pursued trade based on having complementary economies. Australia has a comparative advantage in the types of agricultural products and raw materials that are demanded by Korea, and in turn imports from Korea manufactured products such as autos, electronics and refined petroleum.

Korea's gross domestic product (GDP) has been steadily increasing at an average rate of 4.6 per cent between 1990 and 2010. Although, the agricultural share of Korea's GDP has markedly declined since the 1970's from 27 per cent share to 2.3 per cent share in 2010[2].

In the 1970s there was an expansion in Australia's and Korea's trade relations. Total bilateral trade increased from A$6.6 million in 1965-66 to A$176 million in 1975[3]. Korea is now Australia's fourth-largest overall trading partner (total two-way trade was worth $25.8 billion in 2009-10). Korea was Australia's third-largest goods export market last year (up to $20.4 billion)[4].

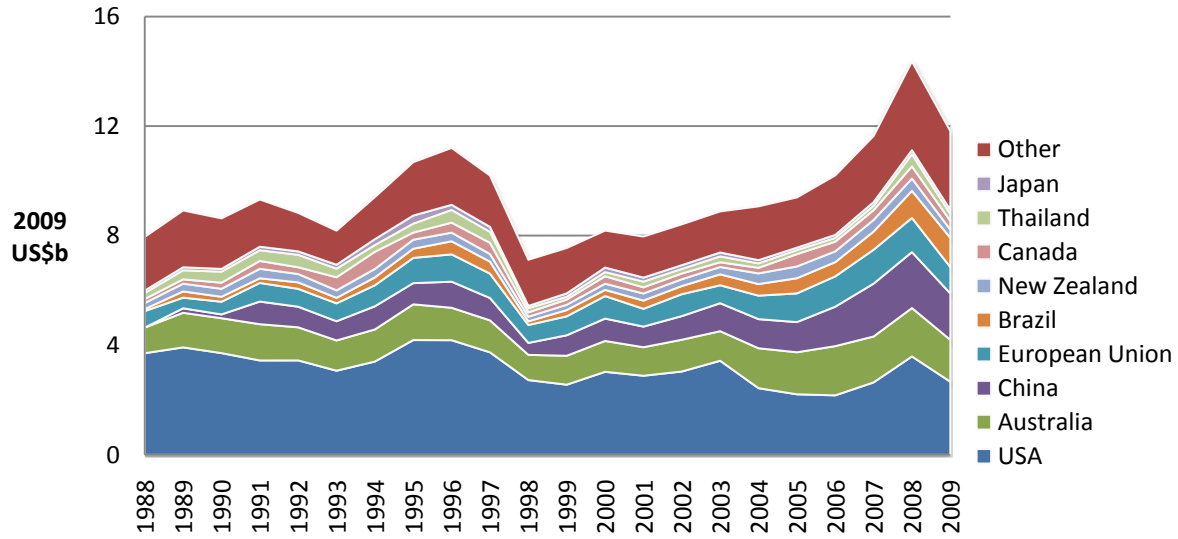
[2] OECD, statistical extracts http://stats.oecd.org/Index.aspx?DatasetCode=SNA_TABLE1
[3] Charles Harvie, *The Australia-Korea Economic Relationship and Prospects for the FTA,* Nov 2004. University of Wollongong.
[4] Department of Foreign Affairs and Trade, Republic of Korea Country brief, http://www.dfat.gov.au/geo/rok/brief_index.html.

VALUE OF AGRICULTURAL, FISHERIES AND FORESTRY GOODS IMPORTS AND EXPORTS, BY COUNTRY

Korean agricultural imports

Korea is a net food importer and Korea imports 8.8 per cent of Australia's total farm exports. In 2009-10, Australia's agricultural exports to Korea were worth over US$1.7 billion. Major exports include beef, raw sugar, wheat, cereal residues and by products (including gluten, starch) and dairy (Figure 1).

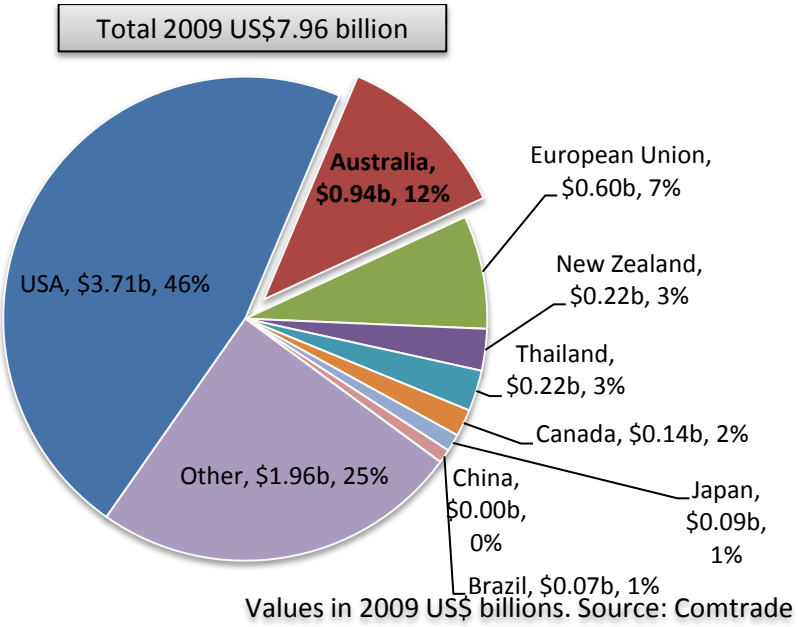
Figure 1 Korean agricultural imports by source, 1988-2009



The United States is Korea's largest source of imported agricultural products, followed in roughly equal value by Australia and China.

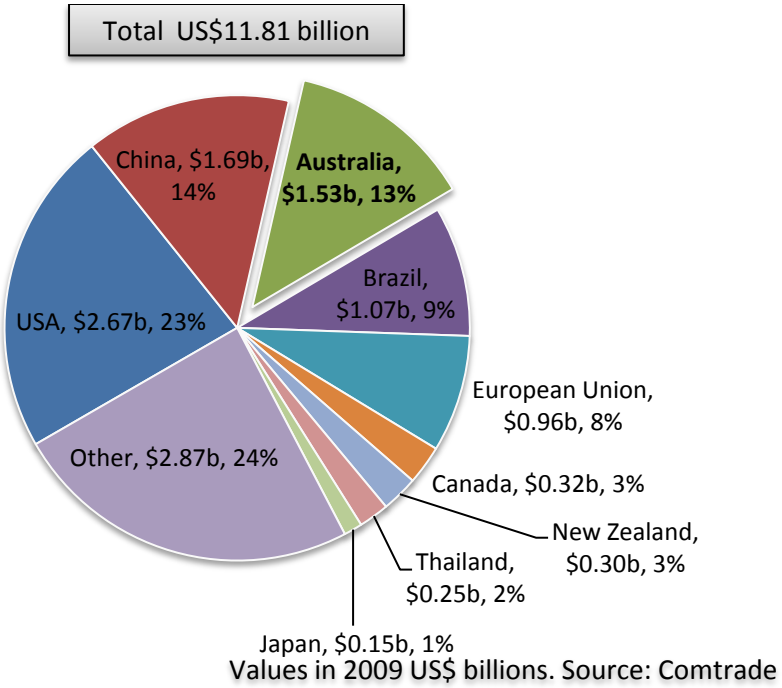
In 1988, Korea's total agricultural imports were worth approximately US$4.42 billion (approximately US$8 billion in 2009 US dollars). The United States is Korea's largest source of agricultural products followed by Australia during in 1988. Korea imported approximately US$520 million of agricultural products from Australia. In 1988 Australia had a 12 per cent market share of Korea's agricultural imports (Figure 2).

Figure 2 Korean agricultural imports, by source, 1988



By 2009, Korea's agricultural imports had increased to a total of US$11.8 billion. Australia's market share increased from 12 per cent in 1988 to 13 per cent in 2009 (Figure 3), peaking in 2006 with an 18 per cent import share, and a low of 11 per cent between 1996 and 1997.

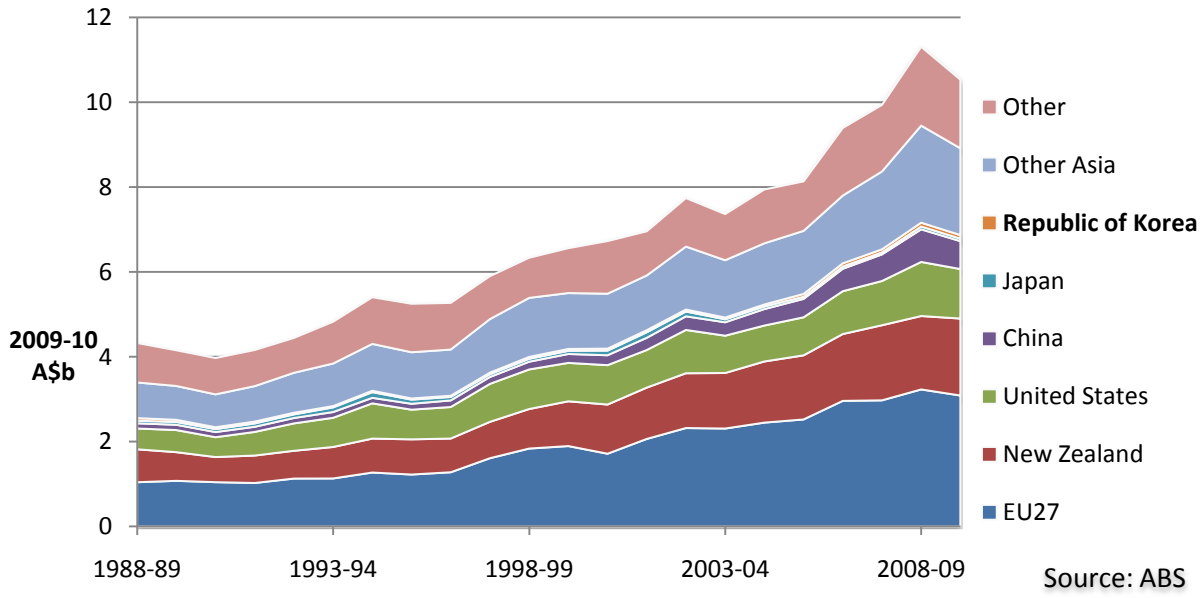
Figure 3 Korean agricultural imports, by source, 2009



Australian agricultural imports

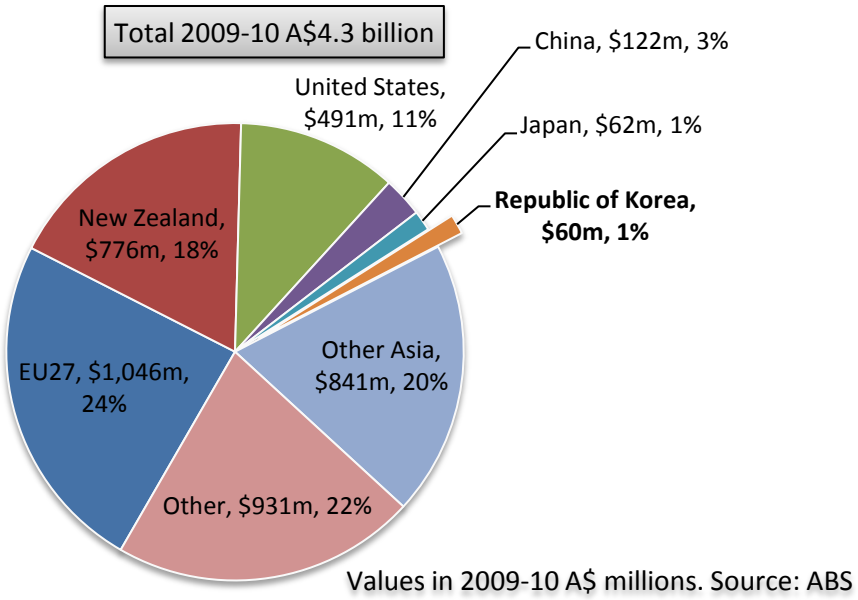
Australia has never been a significant importer of Korean agricultural products. Other countries such as the European Union, United States and New Zealand have played a greater role in Australia's agricultural import picture (Figure 4).

Figure 4 Value of Australian agricultural imports, 1988-89 - 2008-09, by source



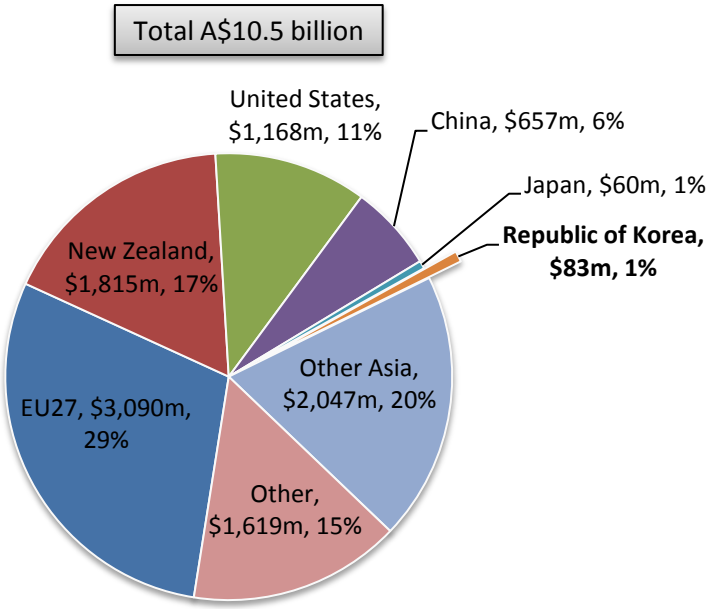
In 1988-89, Australian agricultural and food imports from Korea were small – valued at around A$60 million, accounting for 1 per cent of Australia's agricultural import market. In contrast, Australian imports of agricultural products from the European Union were valued at A$1.04 billion, giving the European Union a 24 per cent share of Australia's agricultural import market (Figure 5).

Figure 5 Australian agricultural imports, by source, 1988-89



By 2009-10 Australia's imports from Korea had not significantly changed, with Korea's share of Australia's imported agricultural and food goods market unchanged at 1 per cent and valued at A$83 million. The European Union has remained Australia's largest source for imported agricultural products, with imports valued at in excess of A$3 billion, giving the European Union a 29 per cent share of Australia's agricultural import market (Figure 6).

Figure 6 Australian agricultural imports, by source, 2009-10

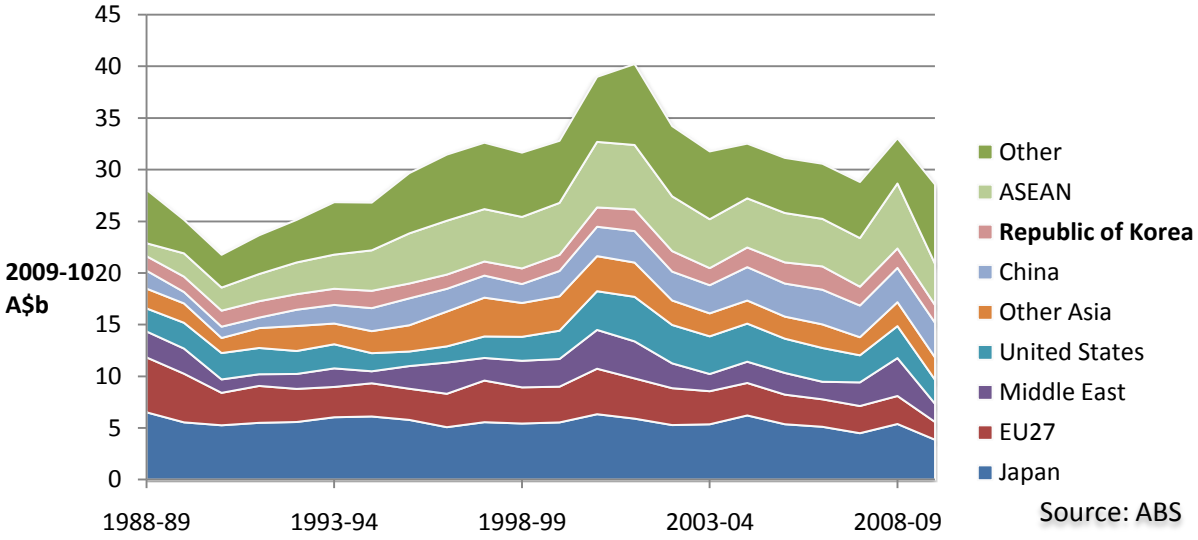


Values in A$ millions. Source: ABS

Australia's agricultural exports

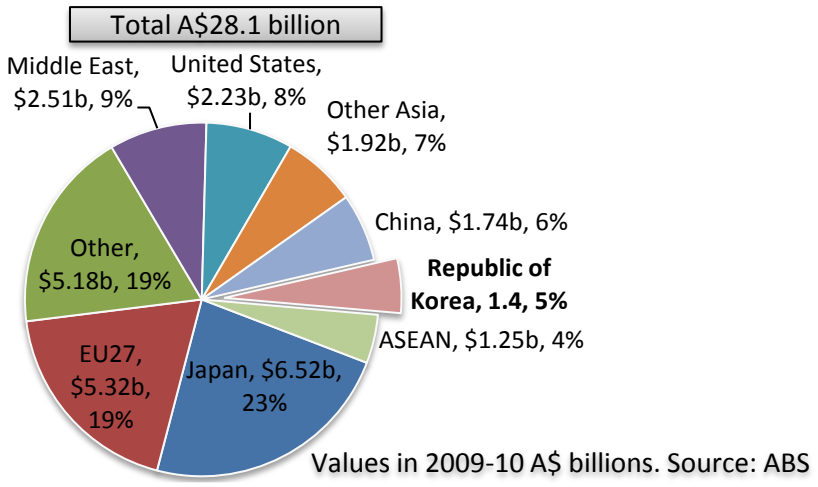
Australia is one of the world's largest agricultural export nations in terms of wheat, beef, dairy products, wine and wool. Australia exports approximately 60 per cent of its agricultural production. Over time the markets with which Australia trades have gradually changed from the markets of Europe and North America to many developing nations (Figure 7). In 2009-10, Korea was Australia's fifth largest export market for agricultural products.

Figure 7 Australian agricultural exports, by country



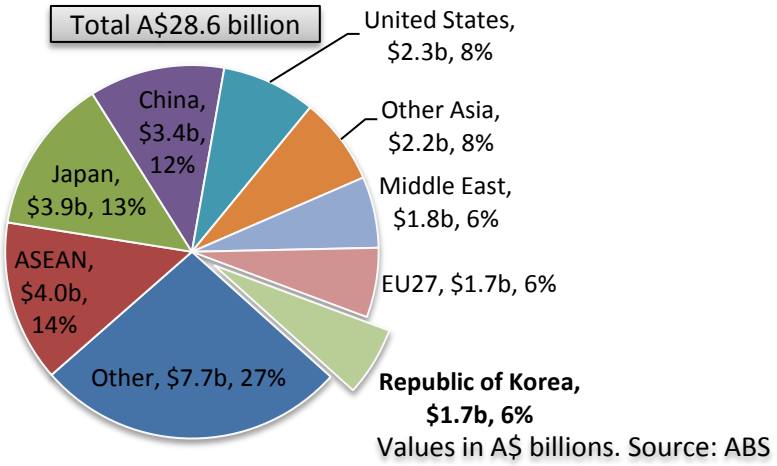
In 1988-89, Korea had a 5 per cent share of Australia's agricultural exports, worth around A$1.4 billion (Figure 8). Japan and the European Union were Australia's largest agricultural export markets, receiving 23 per cent (A$6.5 billion) and 19 per cent (A$5.3 billion) respectively.

Figure 8- Australian agricultural exports, by country, 1988-1989



In 2009-10, Korea's market share of Australia's agricultural exports increased slightly by 1 per cent to 6 per cent, worth A$1.7 billion (Figure 9). Korea's importance as a market for Australian agricultural exports has remained strong, while Australia has sought to service a greater range of countries leading to relative declines in some markets, including for example, Japan, which nevertheless continues to be Australia's largest single export market, worth A$3.9 billion. China has become an important destination for Australian agricultural products, increasing its market share from 6 per cent in 1988-89 to 12 per cent in 2009-10. ASEAN has also increased in importance from 4 per cent market share of Australia's agricultural exports to 14 per cent in 2009-10, worth A$4 billion.

Figure 9 Australian agricultural exports, by country, 2009-10



COMPOSITION OF AUSTRALIA'S TWO-WAY AGRICULTURAL, FISHERIES AND FORESTRY TRADE WITH KOREA

Australian agricultural exports to Korea

The composition of Australia's agricultural trade with Korea has also changed over time.

The total value of Australian agricultural exports to Korea has more than doubled since the late 1990s. This has been mainly the result of increases in the value of beef and veal exports (since the late 1990s) and sugar exports (since the early 1990s)[5].

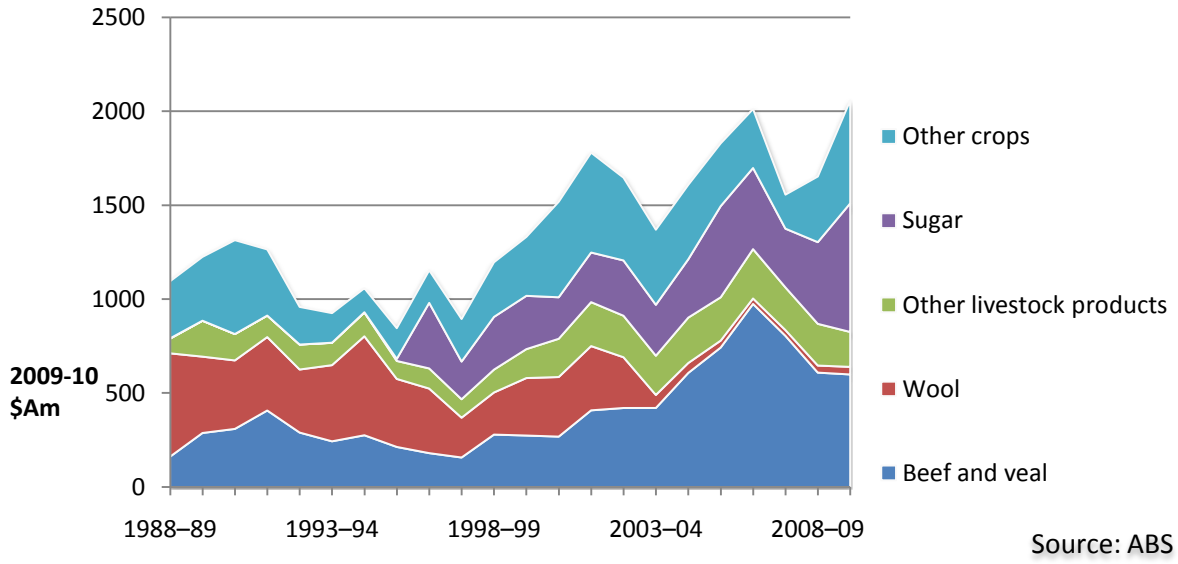
Korea is the third largest importing country of Australian meat and meat products in value and volume terms, with trade totalling over 154, 000 tonnes with an estimated value in excess of A$700 million in 2010-11. Beef is the dominant export product (A$685 million).

Korea is an important market for Australian dairy products with exports remaining relatively steady since 2004-05. In 2004-05, Korea was Australia's 9th largest market, taking A$92.4 million worth of dairy products; of which A$39 million was cheese. In 2008-09, it was the 8th largest market, importing A$113 million worth of products; of which almost $40 million was cheese. In 2009-10, it was the 9th largest market (by value), importing A$92.2 million worth of Australian dairy products; of which almost A$29 million was milk powders and mixtures and A$28 million was cheese.

Korea is also a significant market for Australia's sugar exports – valued at over A$500 million in 2010 for the period January to September (Figure 10).

[5] ABARES using Australian Bureau of Statistics (ABS) data.

Figure 10 Composition of Australian agricultural exports to Korea, 1988-89 - 2009-10



BSE in North America and Australia's beef exports to Korea

Over much of the past decade, Australia's beef exports to Japan and Korea have been supported by Australia's status as being free from major livestock diseases that have interrupted other markets, including those that have historically supplied the Korean market. For example, outbreaks of 'mad cow disease' or bovine spongiform encephalopathy (BSE) in Canada and the United States in 2003 lead to their market access to Japan and Korea being suspended.

The exclusion of North American competitors from the Japanese and Korean markets due to BSE resulted in increases in the value of Australian exports of beef of 81 per cent to Japan and 130 per cent to Korea. Prior to the outbreak of BSE in North America, on a value basis, Australia's exports of beef to Japan were worth A$1,238 million, and to Korea they were worth A$320 million in 2002. At the peak following the closure of those markets to North American suppliers, the value of Australian exports was A$2,245 million (2005) and A$735 million (2006) respectively for Japan and Korea. This is a A$1 billion increase for the Japanese market and a A$415 million increase for the Korean market.

More recently, both Canada and the United States have, at least partially, regained access to both Japan and Korea. The re-entry of these competitors to the Japanese and Korean market is expected to place downwards pressure on Australian beef exports to both markets.

Forestry

Australia's forestry industry does not have substantial trade links with Korea. Total forest product exports to Korea in 2009-10 totaled A$48.4 million, with exports dominated by saw and veneer logs worth A$22.6 million.

The bilateral forestry trade relationship is more significant from the perspective of imports of processed forestry products from Korea. Here, Australia's imports from Korea were valued at A$146.2 million in 2009-10, comprising mostly paper, paperboard and newsprint. Paper-based hygiene products were another significant category of import from Korea (Table 1).

Table 1 Composition of Australian forestry trade with Korea, 2009-10

	A$ million
Top forestry exports	
Saw logs and veneer logs, in the rough	22.6
Coniferous wood – sawn or chipped	6.2
Waste and scrap of paper or paperboard	4.5
Uncoated paper & paperboard	3.1
Wood in the rough	2.4
Total forestry exports	**48.4**
Top forestry imports	
Paper and paperboard	117.7
Newsprint	10.2
Babies' napkins of cellulose wadding	3.7
Paperbooks	2.4
Sanitary towels, napkin liners for babies	1.8
Total forestry imports	**146.2**

Fisheries

Korea is not a significant market for Australian fisheries exports. In 2009-10, Australia's fisheries exports to Korea were valued at A$1.5 million, comprising mainly fats and oils and pearls.

Australia imports more fisheries products from Korea than it exports to that market. In 2009-10, imports of Korean fisheries products were valued at A$7.8 million, comprising mainly processed seafood products, such as fishballs, fishcakes, processed fish, crustaceans, molluscs and other processed seafood products (Table 2).

Korean agricultural exports to Australia

Australia's major imports of food products from Korea include highly processed foods such as sauces; coffee; milled flour and cereal food; bakery products and confectionary.

VALUE OF AGRICULTURAL, FISHERIES AND FORESTRY SERVICES IMPORTS AND EXPORTS, BY COUNTRY

Two-way trade in services related to agriculture, fisheries and forestry is understood to be small. Korea's services market is generally closed to foreign competition, particularly in agriculture.

Table 2 Composition of Australian fisheries trade with Korea, 2009-10

	A$ million
Top fisheries exports	
Fats and oils	0.7
Pearls	0.3
Total fisheries exports	**1.5**
Top fisheries imports	
Fishballs, fishcakes etc	1.7
Products of fish, crustaceans, molluscs or other	1.0
Squid, frozen, dried, salted or in brine	1.3
Total fisheries imports	**7.8**

VALUE OF AGRICULTURAL, FISHERIES AND FORESTRY INVESTMENTS WITH KOREA

In 2009-10 the Foreign Investment Review Board approved 49 proposals from Korea worth around $2.9 billion, however, no investment proposals

requiring Foreign Investment Review Board approval for this period were made in the agricultural, forestry and fisheries sectors[6], or in the preceding nine years.

ABARES is currently undertaking a study into levels of foreign investment in Australian agriculture.

[6] FIRB, *Annual Report 2009-10,* Commonwealth of Australia 2011.

EMERGING AND POSSIBLE FUTURE TRENDS IN THESE RELATIONS

DOMESTIC FACTORS AND FUTURE TRENDS INFLUENCING AUSTRALIAN AGRICULTURE, FISHERIES AND FORESTRY

DEMAND-SIDE FACTORS

Australia is considered a mature market for agricultural products with relatively high per capita consumption by world standards. In most countries, population and income growth are the main driving factors of growth in domestic consumption. The difference is that food accounts for a considerably smaller proportion of expenditure in Australia compared with countries in our region. Australia is a major net exporter of agricultural products with most of its agricultural industries being export orientated.

Total consumption of agricultural products (for example, meat, grains and dairy products) in Australia has risen with population and income growth. Australia's population and per capita income has been growing at an average rate of 1.3 per cent and 2 per cent a year, respectively, between 1990 and 2010. In the four years to 2010, population growth accelerated with higher immigration.

Higher consumption of agricultural products that are used as inputs, such as feed grains, particularly in the expanding poultry industry, has also contributed to the increase in total agricultural consumption in Australia. In addition, recurrent drought over the past decade has resulted in higher feed grain consumption by the beef cattle and dairy industries as pasture growth was affected by the adverse seasonal conditions.

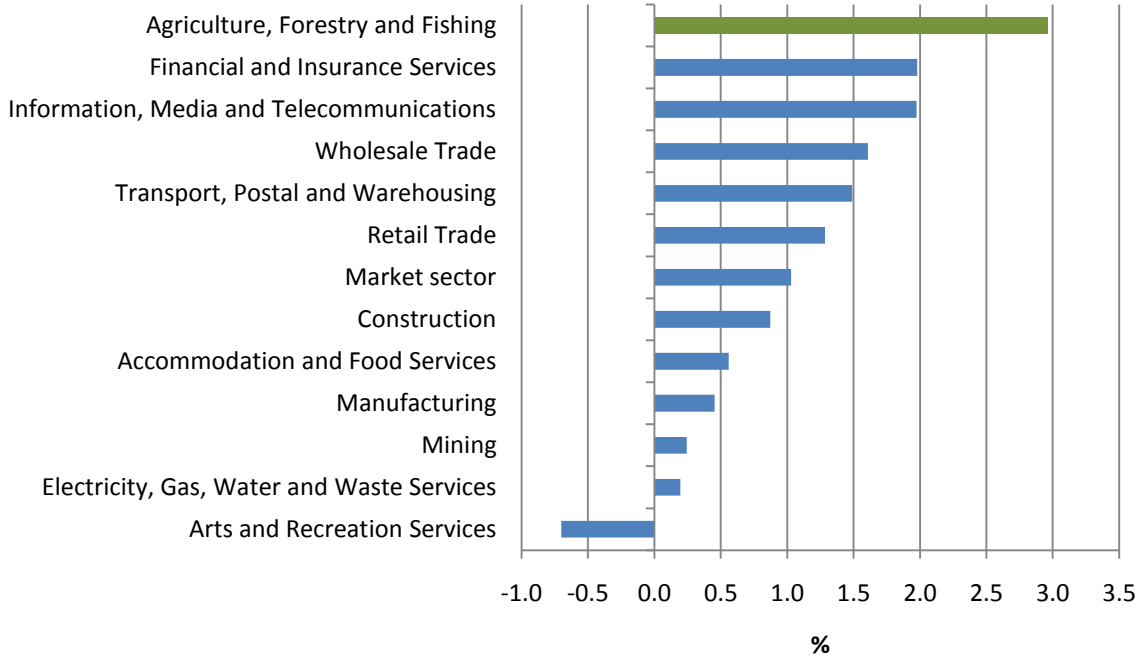
PRODUCTIVITY CHALLENGES

Australia's agriculture sector has achieved substantial productivity gains over the past two decades, exceeding most other sectors of the market economy. This productivity growth has offset a decline in farmer's terms of trade, which has averaged around 1.2 per cent annually (between 1985-86 and 2009–10).

Given their reliance on global commodity markets, Australian producers rely on productivity growth to maintain and improve their international competitiveness.

While comparisons of agricultural productivity between countries are difficult, Australia's productivity performance compares favourably with many other developed countries.

Figure 11 Industry productivity trends, 1985-86 - 2009-10 (annual average growth)[7]



Source: ABS data (2010)

Governments play a key role in creating an innovative operating environment which is conducive to productivity growth. Within the policy mix, strategies to increase Australia's agricultural productivity will continue to include efforts to liberalise global agricultural markets distorted by agriculture support schemes.

NATURAL RESOURCES CHALLENGES

Australia has several natural challenges that limit Australia's ability to increase its agricultural output and thereby increase its supply of agricultural products to overseas markets. These include sustainable land use challenges, climate change and water availability.

The sustainable use of land and appropriate management of natural resources underpins Australia's agricultural food, fisheries and forestry industries. Intensive land uses, such as mining and urban development, involve the greatest level of modification and thus generally have the greatest environmental impact affecting the availability of land for agriculture.

Water is a resource that plays an integral role in all aspects of agriculture. The availability of water in sufficient volumes and of suitable quality is key to agricultural productivity, and this availability is subject increasingly to the vagaries of climate variability and climate change, legacies of water resource over allocation and the intense consumptive use of water from rural

[7] This data series uses the Value Added (GVA) approach to estimate multifactor productivity, which excludes intermediate inputs (such as fuel, fertiliser and contract services). Productivity growth rates (for all industries) are likely to be higher than when all inputs are considered.

and urban development. Water quality is affected by environmental derived contaminants such as salinity, and human activities such as urbanisation and mining.

DOMESTIC FACTORS AND FUTURE TRENDS INFLUENCING KOREAN AGRICULTURE, FISHERIES AND FORESTRY

DEMAND-SIDE FACTORS

Korea is a net importer of food. As Korea's food consumption pattern changes so do their agricultural imports. Over the past few decades Korea's food consumption has changed due to economic growth and the adoption of the 'Western' lifestyle. As the economic status of Korean households improves and their incomes increase (The average monthly household income amounted to around 3,858 thousand won (or A$3,622[8]) in the first quarter 2011, up 3.5 per cent from the first quarter 2010 [9]), the traditional food intake pattern has changed with an increase in animal food consumption.

Cereal and soybean consumption shows a gradual decrease from 1969 while there has been a slight increase in the amount of vegetables consumed. The main types of fresh vegetables includes radish, Chinese cabbage, garlic, onions, and peppers, while processed vegetables consumed include canned vegetables, half-cooked vegetables and dried vegetables. Australia exports some fresh vegetables to Korea. The consumption of fruit has also increased as has meat and poultry intake. The consumption of fish and shell fish has also increased (Table 3).

[8] Converted using the average Australian dollar - Korean won exchange rate for 2010 which was 1065.
[9] http://kostat.go.kr/portal/english/news/1/7/index.board

Table 3 Food consumption in Korea, per person, 1965-2005[10]

		1965	1975	1985	1995	2005
daily calorie intake per person						
vegetable products	cal.	2 345	2 212	2 384	2 520	2 559
	%	96.1	92.6	88.7	85.2	84.9
animal products	cal.	95	178	303	439	455
	%	3.9	7.4	11.3	14.8	15.1
total	cal.	2 440	2 390	2 687	2 959	3 014
consumption per person		kg	kg	kg	kg	kg
food grains		177.1	193.8	169.3	148.5	122.3
rice, milled		121.8	123.6	128.1	106.5	80.7
barley, milled		36.8	36.3	4.6	1.5	1.1
wheat		13.8	29.5	32.1	33.9	31.8
corn		0.9	2.4	3.1	3.3	4.9
miscellaneous grains		3.8	2.0	1.4	3.3	3.8
starchy roots		92.5	35.0	11.9	11.0	17.2
potatoes		7.3	7.1	3.1	3.0	4.2
sweet potatoes		76.5	23.7	5.5	3.7	4.8
sweeteners		1.3	5.2	11.7	17.8	21.3
pulses		5.9	8.3	10.7	11.1	11.2
soybeans		4.4	6.4	9.3	9.0	9.0
vegetables		45.5	62.5	98.6	160.6	144.9
fruit		9.8	18.6	36.0	54.8	62.6
meat		4.7	6.4	14.4	27.4	31.9
bovine meat		1.0	2.0	2.9	6.7	6.6
pig meat		1.9	2.8	8.4	14.8	17.8
poultry meat		0.5	1.6	3.1	5.9	7.5
eggs		1.9	4.0	6.3	8.6	9.1
milk		0.3	4.6	23.8	47.8	62.7
oils and fats		0.4	2.7	9.2	14.2	18.5
seafood		18.0	29.9	37.2	45.1	48.1

PRODUCTIVITY CHALLENGES

Korea has many productivity challenges. Korea's arable land is limited, farm sizes are small and farm incomes fall below those of other sectors. Like Australia, Korea also has an aging farm population. Recently, the outbreak of Foot and Mouth Disease has caused substantial disruption to livestock industries in Korea, although the outbreak may not have a substantial bearing on long-term productivity.

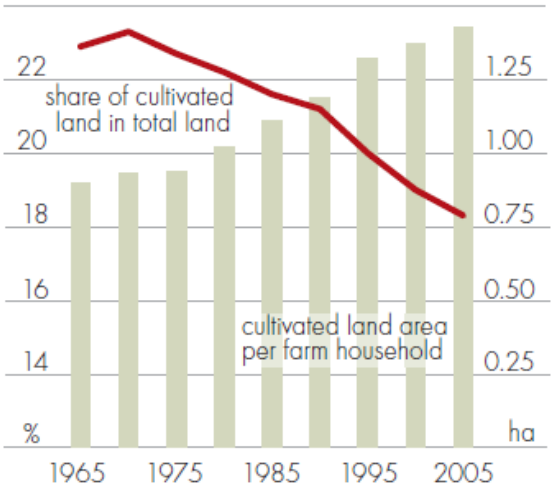
Limited arable land

Korea has a land mass of 10 million hectares, less than one-fifth is cultivated for agriculture. In1965, the share of cultivated land was 22 per cent of the total land mass, this has decreased to 19 per cent in 2005 (Figure 12).

While arable land has been decreasing the size of farms have been increasing. In 1965 the average farm size was 0.9 hectares, this increased to 1.4 hectares in 2005.

[10] ABARES, *Australian Commodities* vol.14 no.3, September quarter 2007

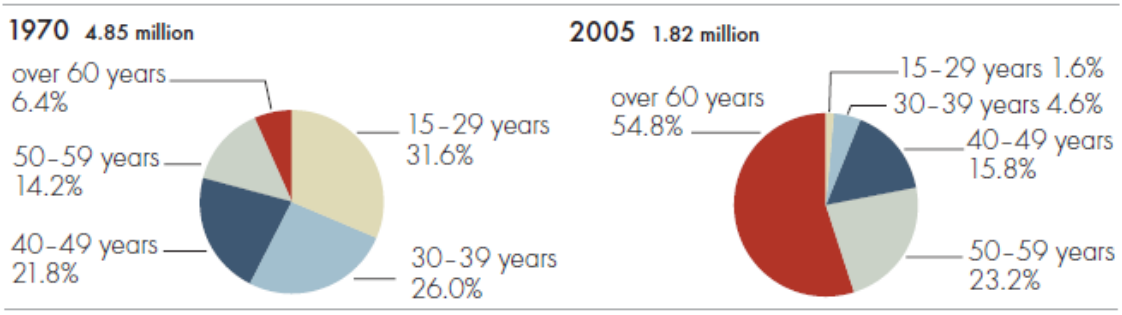
Figure 12 Cultivated land area in Korea, 1965-2005[11]



Aging rural population

Korea's farm population is declining and aging. The number of farm households declined from 2.5 million in 1970 to less than 1.3 million in 2005. As an increasing number of younger members of farm households migrate to urban areas, farms are increasingly dependent on aging household members. In 2005, the proportion of the farm population over 60 years old accounted for 54.8 per cent of the total farm population compared to 6.4 per cent in 1970[12] (Figure 13). This greatly affects Korea's ability to increase productivity in its agricultural sector.

Figure 13 Farm employment in Korea, by age group, 1965-2005[13]



FMD OUTBREAK IN KOREA

The outbreak of foot and mouth disease (FMD) on Korea has had large repercussions for Korea's agricultural productivity, specifically for beef, pork and dairy.

[11] ABARES, *Australian Commodities* vol.14 no.3, September quarter 2007.
[12] Gurung, Rajendra et al, *South Korea Agriculture Policy Review*, Vol.5, No.1, Agriculture and Agri-Food Canada, May 2009.
[13] ABARES, *Australian Commodities* vol.14 no.3, September quarter 2007.

The current outbreak started on 29 November 2010 in Andong, North Gyeongsang Province and is the worst to hit the country. Earlier outbreaks in 2000, 2002 and January and April 2010, were quickly contained with the longest case lasting 52 days in 2002.

The outbreak not only required significant resources to mount the emergency disease response but also to continue to manage the FMD outbreak. The financial burden is reported to have been in excess of US$ 1.8 billion.

Nearly 3.3 million pigs and more than 158,000 cattle have been culled. Thirteen million cattle and pigs have been vaccinated in an effort to control the disease[14]. As of February 2011 3,479,000 livestock had been destroyed.

The outbreak and consequent culling of a large proportion of Korea's cattle and pig herds has lead to tighter supply, forcing the Ministry for Food, Agriculture, Forestry and Fisheries (MiFAFF) to initiate (in the short to medium term) a reduction in tariffs on live dairy cows (and a number of other products including maize, soymeal[15]) from overseas.

Importing dairy cattle

Korea has experienced a decline in milk production due to the outbreaks of FMD. Before the most recent outbreak of FMD in November 2010, the number of dairy cattle in Korea was 429,500 however as a result of the outbreak around 36,000 (8.5 per cent) were destroyed.

MiFAFF have indicated they will review the possible importation of live dairy cattle, stating that dairy cattle for breeding may be imported within the quota volume (1,067 cows) with duty exemption every year. MiFAFF will review the increase of quota volume in the latter half of 2011 when FMD is expected to be under control[16].

Special duty exemption scheme

In response to the impacts of the FMD outbreak on the agriculture sector, Korea has reduced tariffs on a number of other agricultural inputs and products until December 2011 including fish, vegetable seeds and oils, yarn, live chickens and some machinery. Tariffs on a total of 324 lines were temporarily reduced. For example, tariffs on a number of dairy products have been reduced to zero from as high as 40 per cent.

On 10 March 2011, MiFAFF announced their aim to increase the milk production quota per dairy farm and provide a concessive tariff for dairy products to lower the import price as part of its strategy to stabilise the raw milk supply situation[17].

The reduced tariff for dairy products and increased quota volumes will last until December 31 2011 (Table 4).

[14] Dairy Australia, *Dairy Market Assessment Report – South Korea*, April 2011.
[15] http://www.fao.org/giews/countrybrief/policy_detail.jsp?code=KOR#KOR.
[16] Dairy Australia, *Dairy Market Assessment Report – South Korea*, April 2011.
[17] Dairy Australia, *Dairy Market Assessment Report – South Korea*, April 2011.

Table 4 Temporary changes to Korea's import tariffs for dairy products[18]

Items	Import duty		Import quota		
	Standard (%)	Special Duty (%)	Volume (tons)	Completion date	Responsible agency
Frozen Cream	36	0	17,000	31 Dec 2011	Korea Dairy Industries Association (KDIA)
Butter	40	0	3,500		
Cheese (Mozzarella, Cheddar)	36	0	23,000		
Lactose	20	0	20,000		
Cocoa preparation	8	0	5,000		
Butter blend	8	0	40,000		
whole milk powder skim milk powder	40 20	0	4,000 26,000		

DOMESTIC AGRICULTURAL AND TRADE POLICY REFORM CHALLENGES

When the Korean War ended in 1953, Korea was one of the poorest countries in the world. Korea's production returned to pre-war levels by the end of the 1950s, the Korean economy was heavily dependent upon foreign aid and characterised by low domestic savings and limited natural resources. The Korean government has since used a range of policy instruments to protect and sometimes promote some sectors or industries that were thought to be strategically important for the economy, especially through trade protection and financial subsidies. Overall, the Korean government's approach has succeeded in improving incomes.

Domestic support for agriculture

Korea's support of the agriculture sector ranks among the highest in the world. According to the OECD Korea's average "Producer Support Estimates (PSE)" declined from 70 per cent during 1986-88 to 62 per cent during 2005-07. Even at this rate it equates to more than double the OECD average. The OECD further estimates that support measures that increase domestic prices account for 91 per cent of the producer support in 2007.

Estimates from the OECD (2009) indicate that government support to farmers in Korea accounted for around half of gross farm receipts (2007-09 average - 52 per cent and 47 per cent respectively).

The level of producer support (expressed as per cent of producer revenues) in OECD countries in 2007-09 ranged widely: it was less than 1 per cent in New Zealand, 4 per cent in Australia, to 52 per cent in Korea and 61 per cent in Norway. The structure of support also varies considerably among countries. Among the countries with the highest level of support the share of the potentially most distorting policies represents around 90 per cent in Japan and Korea, it is around 70 per cent in Iceland and around 50 per cent in Norway and Switzerland.

[18] [18] Dairy Australia, *Dairy Market Assessment Report – South Korea*, April 2011.

There are a number of different payment methods Korea uses including direct income support for paddy fields, direct payment for less favoured areas and payment for environmental conservation[19].

FOOD SUPPLY

Korea's agriculture policies are largely driven by the desire for self-sufficiency in agricultural production and the protection of its agricultural industries. The agricultural sector is heavily subsidised and there are significant barriers to the importation of agricultural products (barriers to trade will be discussed in a separate section).

In the late 1960s, Korea shifted its strategy from food security based on imports from the United States to one of food security based on domestic production[20]. For example, crop production in Korea receives the greatest share of commodity specific support. A major objective for Korea is retaining domestic self-sufficiency in the production of rice[21]. Rice production in Korea covers more than 50 per cent of the cultivated land and remains the main agricultural commodity in Korea.

In another measure to sure up Korea's national food security, MiFAFF recently announced its Basic Plan to address climate change for 2011-2020. The plan includes efforts to support the sustainable growth of food, agriculture, forestry and fisheries industries that are susceptible to adverse impacts of climate change.

One of the other avenues Korea seeks to address the need for a stable supply of food is through its FTA agenda.

BILATERAL FACTORS AND FUTURE TRENDS INFLUENCING AUSTRALIA AND KOREA'S AGRICULTURAL, FISHERIES AND FORESTRY RELATIONSHIP

COOPERATION IN AGRICULTURE

Agricultural trade has been supported by the longstanding linkage between the two countries which began in 1975 with the signing of the Agreement on the Development of Trade and Economic Relations and the Australia-Korea Foundation established in 1992.

Australia and Korea share a growing bilateral relationship. This is reflected in the various cooperation activities and initiatives undertaken by the two economies in the field of agriculture. Cooperation between the two countries ranges across a number of key areas including technical market access and policy issues.

Bilateral discussions

Cooperation between Australia and Korea on technical market access issues has been strong with each country progressing each other's animal and plant market access requests.

[19] Gurung, Rajendra et al, *South Korea Agriculture Policy Review*, Vol.5, No.1, Agriculture and Agri-Food Canada, May 2009
[20] As above.
[21] As above.

Annual bilateral plant quarantine technical meetings

Plant quarantine talks are attended by senior officers from the Australian Government Department of Agriculture, Fisheries and Forestry and Korean Animal, Plant and Fisheries Quarantine and Inspection Agency (QIA) and provide a useful forum for discussion of Australia's and Korea's market access issues.

Annual bilateral animal health and quarantine meetings

Animal health talks are attended by senior officers from the Australian Government Department of Agriculture, Fisheries and Forestry and Korean Animal, Plant and Fisheries Quarantine and Inspection Agency (QIA) and provide an opportunity to discuss market access issues. The inaugural talks were held in Canberra on August 2009. Further meetings have been delayed due to the FMD outbreak in Korea.

Australia's agriculture related Memorandum of Understandings (MoU) with Korea

The Department of Agriculture, Fisheries and Forestry has a number of MoUs with Korean counterparts including on animal health and quarantine matters, forestry and collaboration in economic agricultural joint research projects.

FISHERIES

Often, views and approaches of fishing nations to fisheries management are quite different. This can lead to challenges in obtaining agreement to many of the proposals on fisheries management in the international arena.

Korea is very active in the Regional Fisheries Management Organisations of which Australia is a member. This includes the Commission for the Conservation of Southern Bluefin Tuna, the Western and Central Pacific Fisheries Commission and the Indian Ocean Tuna Commission. Like Australia, Korea is a signatory to the Convention establishing the South Pacific Regional Fisheries Management Organisation, which has not yet come into force.

In these organisations Australia endeavors to cooperate with Korea to seek agreement to measures that are consistent with the interests of coastal states in the region to achieve sustainability of the fish stocks managed by each organisation.

THE AUSTRALIA-KOREA FREE TRADE AGREEMENT NEGOTIATIONS

The FTA negotiations strengthen the understanding of each nation's trade environment which allows for closer ties between Australia and Korea.

In April 2011, Prime Minister Julia Gillard and Korean President Lee agreed to a goal of concluding the Australia-Korea Free Trade Agreement negotiations by the end of 2011. Australia is striving for a comprehensive and ambitious FTA that will provide meaningful outcomes for agriculture, fisheries and forestry industries.

Five rounds of FTA negotiations and four intercessional rounds have been held with Korea since May 2009. Overall progress on negotiations has been rapid. Australia's main competitors in the market, the US and the EU, have already concluded negotiations on FTAs with Korea. For details

of Korea's agreement with the US and EU, the Department of Agriculture, Fisheries and Forestry refers the Sub-Committee to the submission on Korea provided jointly by the Department of Foreign Affairs and Trade and Austrade.

The Korea-EU FTA entered into force on 1 July 2011. The EU is a competitor in the Korean market for some of Australia's key agricultural export interests, particularly in dairy and wine. Similarly, Korea and the United States have finalised but not yet ratified, an agreement that will increase competitive pressure on Australia, especially in beef exports. Australia's leading position in Korea's beef market stands to be eroded over time if an FTA cannot conclude a comparable deal.

Maintaining and improving market access for Australia's portfolio industries will be increasingly important to Australian farmers.

BARRIERS AND IMPEDIMENTS TO TRADE AND INVESTMENT WITH KOREA FOR AUSTRALIAN BUSINESSES

TRADE POLICIES IN KOREA AFFECTING AGRICULTURAL TRADE WITH AUSTRALIA

The Department of Agriculture, Fisheries and Forestry refers the Sub-Committee to the submission on Korea provided jointly by the Department of Foreign Affairs and Trade and Austrade (DFAT/Austrade submission for this inquiry) for a detailed discussion of trade barriers that Korea has implemented. These include high ad valorem and specific tariffs, import quotas, tariff-like duties and complicated trading arrangements, often implemented by state trading enterprises.

Korea has embarked on significant trade liberalisation since the 1980s, reducing average tariff rates substantially, and significantly liberalising the services and investment sectors, though tariffs in some sectors, particularly agriculture, remain high and restrictions apply across a range of service industries and on investment. In contrast, Australia is operating from a low tariff base on agricultural products.

TARIFF BARRIERS

Since the 1980s Korea has embarked on opening up its economy, reducing average tariff rates substantially. The simple average tariff rate in 1982 was nearly 24 per cent, declining to about 10 per cent in 1992 (for all goods). In 1995 the Uruguay Round Agreement on Agriculture (URRA) Korea converted many quantitative import restrictions to tariffs. Some, including rice, remain protected by quota arrangements.

Korea continues to maintain high tariffs on selected goods. Korea imposes the highest tariffs on commodities including beef and offal 18-40 per cent, dairy 8-176 per cent, malting barley 513 per cent and potatoes: 27-304 per cent. Vegetables, fruits and nuts, cattle, sheep, goats and horses, and beverages and tobacco products also incur high average tariffs exceeding 20 per cent.

The average applied tariff on agricultural products is eight times higher than that applied to non-agricultural products.

IMPORT QUOTAS

Korea has 179 tariff rate quotas for agricultural products including rice, milk powder, and potatoes. In quota tariffs range from zero to 50 per cent while out of quota applied tariffs can reach over 887 per cent[22].

STATE TRADING ENTERPRISES AND SIMILAR ARRANGEMENTS

Tariff rate quotas are administered by 22 different organisations including government departments state controlled enterprises and various producer associations, for example the Korea Dairy Industries Association, the Korean Agro-Fisheries Trade Corporation. In some cases

[22] Further information can be gained from the DFAT/Austrade submission for this inquiry.

the administering entity is owned and controlled by the domestic producer directly competing with imported items, for example raw ginseng, pine nuts and citrus fruit[23]. The WTO[24] notes this raises potential conflicts between the state trading enterprise and importing interests and their farm constituents.

TECHNICAL MARKET ACCESS

Technical market access includes government technical regulations and standards and industry standards for goods that can impact on international trade. These requirements are covered by the WTO SPS Agreement or measures applied to protect human, animal and plant health from pests and diseases, additives, toxins and contaminants in foods and feedstuffs; and the WTO TBT agreement dealing with procedures for testing and certifying conformity to technical regulations (compulsory) and standards (voluntary) governing international trade.

Korean consumers are concerned about the safety of the food they consume, specifically heightened following outbreaks of FMD in Korea and the 2003 occurrence of bovine spongiform encephalopathy in North America which affected meat and dairy supplies.

There are two specific ministries which set and enforce standards for the agricultural sector both domestically and for imports. These are the Ministry of Health and Welfare which includes the Korean Food & Drug Administration and the Ministry of Food, Agriculture, Forestry and Fisheries. Under MiFAFF, and the following the recent FMD outbreak, the quarantine agencies have recently been restructured to combine the National Plant Quarantine Agency, National Veterinary Research and Quarantine Service and National Fisheries Products Quality Inspection Service into the Animal, Plant and Fisheries Quarantine and Inspection Agency (QIA).

SANITARY AND PHYTOSANITARY CONSIDERATIONS AFFECTING BILATERAL TRADE

Cooperation between Australia and Korea on technical market access issues has been good. Gaining quarantine access to Korea for agricultural products involves a formal request by Australia, an exchange of information and a detailed risk analysis by the relevant Korean Government agencies. Korea generally notifies changes to import requirements through the World Trade Organisation Sanitary and Phytosanitary process, with Australia providing responses to these notifications as required.

Plant and plant product

Australia has had a history of successful exports to Korea. Korea has a conservative approach to plant quarantine and it is essential that Australia provides high quality submissions and research to Korea. Previous and ongoing issues Australia has in gaining, maintaining and improving market access include the time taken for Korea to progress Australia's plant product requests, providing sufficient research to support proposed risk management measures and the high cost of pre-clearance.

[23] Gurung, Rajendra et al, *South Korea Agriculture Policy Review*, Vol.5, No.1, Agriculture and Agri-Food Canada, May 2009
[24] WTO, *Trade Policy Review of the Republic of Korea: Report by the Secretariat,* (WT/TPR/S/2004), 2008.

For Australia, market access requests in priority order, are table grapes and mainland cherries. For Korea, market access requests in priority order, are table grapes, chestnuts and strawberries. Australia and Korea are currently progressing each party's market access for table grapes.

At this time, there are no significant specific plant and plant product technical market access issues with Korea.

Meat and meat products

Australia has had a history of successful exports to Korea of meat and meat products from a range of livestock including cloven hoofed species, poultry and kangaroo. At this time, there are no significant meat and meat product technical market access issues with Korea.

Documentation issues may at times hamper clearance of meat and meat product exports into Korea. All health certificates must arrive in advance to the consignment being presented for inspection. Exporters who do not comply with this requirement for any reason risk rejection of consignments. AQIS officers continue to hold discussions with Korea to explore the opportunity of moving to an electronic certification system for submitting documentation, which if implemented, may help address the issue of delays in certification.

Australia is improving its export meat inspection system through the development of the Australian Export Meat Inspection System (AEMIS). AEMIS will change the way Australia ensures the safety of Australian meat and meat products destined for domestic and export markets. Korea has been consulted closely on the new system.

Dairy products

Korea is an important market for Australia's dairy products. At this time, there are no significant dairy technical market access issues with Korea.

Chemical residue standards

The Korea Food and Drug Administration (KFDA) proposed amendments to its Standards and Specifications for Food in a notification to the World Trade Organisation Sanitary and Phytosanitary (SPS) committee in January 2011. KFDA has since clarified that it has adopted an import tolerance system and is in the process of implementing a positive list system for managing maximum residue limits (MRLs) in foods, taking into consideration the Codex Alimentarius Commission (international food safety standard setting organisation) standards. KFDA has advised that it has set a zero tolerance for 155 pesticides. Some of these pesticides are registered for use in Australia in the production of agri-foods for export to Korea. KFDA has indicated it is willing to review its import tolerances for certain pesticides with the submission of relevant data in support of Australian MRLs.

Australia and Korea are actively co-operating to support the establishment of MRLs to protect the health of consumers as well as facilitate trade.

The Australian Government established the National Residue Survey (NRS) in the 1960s. The NRS is a program within DAFF that assists industry by providing risk-based residue testing services on a cost recovery basis to support market access. Industries participate in the NRS on

a voluntary basis and are provided with the results of residue monitoring. Export certification is administered under the Export Control Act 1992. Data from NRS residue monitoring for animal products supports export certification to meet importing countries market access requirements. Australia has no export certification requirements for residues for any plant products.

Organic food products

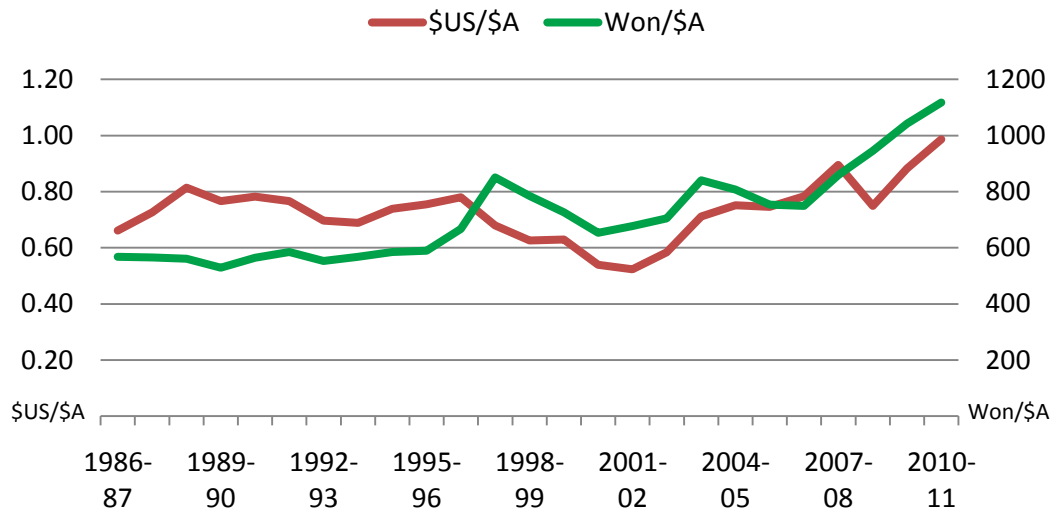
Australia (together with other like-minded trading partners) provided extensive comments on Korea's proposed amendments to its regulations for the import of organic food products, to minimize disruption to Australian exports. MiFAFF has announced implementation of revised organic food products legislation would be delayed until 31 December 2012. This affords an opportunity to seek equivalence recognition of Australia's systems for certifying organic produce.

OTHER FACTORS

CURRENCY MOVEMENTS

The value of the Australian dollar is a factor influencing trade. The Australian dollar has steadily increased against the Korean won since the mid-1980s. From an average of around ₩567/Australian dollar in 1986-87, the value of the Australian dollar has almost doubled to average around ₩1118/Australian dollar in 2010-11 (Figure 14)[25].

Figure 14 Republic of Korea won/Australian dollar exchange rate, financial year average



Looking forward, the strong Australian dollar may put pressure on Australia's agricultural exports to Korea as a stronger Australian dollar makes Australian exports more expensive to Korean importers.

[25] ABARES

GLOBAL FACTORS INFLUENCING AUSTRALIA AND KOREA'S AGRICULTURAL, FISHERIES AND FORESTRY RELATIONSHIP

MULTILATERAL TRADE ARRANGEMENTS

Korea and Australia are both members of the World Trade Organization (WTO), the G20, the Food and Agriculture Organization (FAO) and the Organisation for Economic Co-operation and Development (OECD).

In the WTO, Korea is a (self-nominated) developing country member, whilst in the OECD it is a developed economy. Australia and Korea share different perspectives with respect to support for and openness of Australia's agricultural sectors. Nevertheless Korea is a cooperative partner and both countries work well together. The WTO provides a forum for discussion of our respective agricultural policies and for either country to raise any concerns in respect of those policies.

Both Australia and Korea are committed to concluding the WTO Round of trade negotiations. Even if there is no conclusion to the Round in the short-term Australia and Korea will continue to engage on agricultural issues through the WTO.

Australia played an important role in supporting and advocating Korea's membership to the OECD prior to its accession on 12 December 1996. Korea plays an important role in helping to ensure economic issues of relevance to the Asia-Pacific region are covered in the OECD's work program. Australia will continue to work with Korea in supporting work of regional significance.

Korea is engaged in the FAO and hosted the biennial FAO Asia-Pacific Regional Conference in 2010, which focused on providing greater strategic input to the FAO on regional priorities.

REGIONAL TRADE ARRANGEMENTS

Korea is a signatory to two regional trade agreements. These are the Association of South East Asian Nations (ASEAN) (Australia; Brunei; Myanmar; Cambodia; Indonesia; Lao People's Democratic Republic; Malaysia; Philippines; Singapore; Viet Nam; Thailand) and the European Free Trade Association (EFTA) (Iceland; Liechtenstein; Norway; Switzerland).

BILATERAL TRADE ARRANGEMENTS WITH THIRD COUNTRIES

As more free trade agreements are signed by Korea it is in Australia's interest to vigorously pursue its FTA to ensure market share for Australian companies are able to access markets on terms that are equivalent to competitors who may have FTAs in place.

Since 2003, Korea has actively engaged in FTA negotiations with over 50 countries. So far, Korea's FTAs with Chile, EU (KOREU), Peru, Singapore, India, EFTA and ASEAN have entered into force. Korea-US FTA (KORUS) was signed in April 2007, renegotiated in 2010, and currently awaits approval for ratification.

Korea is also negotiating agreements with Canada, Mexico, Japan, China and New Zealand, but these negotiations are less advanced than the Australia-Korea FTA negotiations.

OPPORTUNITIES FOR DEEPENING EXISTING COMMERCIAL LINKS, AND DEVELOPING NEW ONES, WITH KOREA

Korea is further down the path to opening its agriculture sector than its larger neighbour, Japan, because it has pursued FTAs with the European Union and the United States, two of the world's largest agricultural trading countries. It has also concluded agreements with other countries with more specific agricultural trading interests, including Chile and Peru. These agreements are forcing a degree of liberalisation of Korea's agriculture sector. Nevertheless, with the conclusion of an FTA with Australia, good commercial opportunities should arise, including in trade in services and a more liberal investment regime.

As well, Australia and Korea have established a good basis for progressing cooperation in agriculture. For example, the Australian and Korean dairy industries recently signed a Memorandum of Understanding providing for closer farmer-to-farmer cooperation. This proactive approach to cooperation will bring benefits for the industries involved, and may help to identify opportunities for Australian firms to provide consultancies and other advisory services to assist Korean agriculture.

FACILITATING COMMERCIAL RELATIONSHIPS

DAFF does not specifically work to develop new commercial linkages with Korean counterparts to Australian firms. However, the department does have a role in supporting existing commercial relationships because of its work in technical market access. This work facilitates trade and may make possible new commercial relationships. For example, the work the department does in negotiating market access protocols, in accordance with strategic priorities established jointly by industry and government, opens doors for producers of farm products in Australia to establish new commercial relationships with counterparts in Korea. However, the department does not have a role in commercial match-making.

The department's work in this area is achieved through annual bilateral discussions; cooperation at the multilateral level; and high level government-to-government /industry –to-government visits between Australia and Korea.

THE ROLE OF THE GOVERNMENT IN IDENTIFYING NEW OPPORTUNITIES AND ASSISTING AUSTRALIAN COMPANIES TO ACCESS EXISTING AND POTENTIAL OPPORTUNITIES IN KOREA

DAFF'S INVESTMENT IN THE BILATERAL RELATIONSHIP

DAFF'S PRESENCE IN KOREA

DAFF is represented in Korea by a permanent counsellor posted to the Australian Embassy in Seoul, along with a locally engaged staff member dedicated to supporting the agricultural relationship with Korea. The DAFF counsellor acts as an interface between the Australian Government and the Korean Government and Korean industry to maintain and improve market access opportunities for portfolio industries and to facilitate trade with Korea.

DAFF'S ROLE

DAFF engages directly with Korea on agricultural, fisheries and forestry trade issues and bilateral cooperation. The department:

- supports and strengthens the bilateral agricultural relationship through annual bilateral discussions on plant and animal technical matters and hosting visits to exchange information on broader agricultural and quarantine policies and practices;
- works with Korea to maintain existing and establish new market access for exports; and
- cooperates with Korea on standards to minimise impacts on trade.

DAFF supports DFAT in FTA negotiations and works with Korea in number of multilateral fora on matters important to the department's portfolio industries.

OTHER AGENCIES AND ORGANISATIONS WORKING TO FACILITATE TRADE AND INVESTMENT

Several Australian Government agencies invest resources in the trade and investment relationship with Korea. Chief among these is the Department of Foreign Affairs and Trade, and Austrade. A number of other agencies engage with Korea along the lines of their portfolio responsibilities.

DAFF works with and supports other linkages, including through close cooperation with industry groups and research and development organisations as well as broader forums including the Australia-Korea Foundation.