

1 November 2012

Tasmania's Place in the Asian Century Issues Paper
Policy Division
Department of Premier and Cabinet
GPO Box 123
Hobart
TAS 7001

Dear Premier Giddings

Thank you for the opportunity to respond to the issues paper 'Tasmania's Place in the Asian Century'. At Fonterra we believe it is extremely timely to be examining how Tasmania can make the most of emerging economic opportunities in the Asian region, particularly in the dairy sector which has a strong future growth outlook in Tasmania.

As you may know, Fonterra's operations in Tasmania are an important part of our Australian network. We are the largest dairy processor in the State, and through our sophisticated, integrated supply chain we are a major exporter of dairy products to Asia from Australia:

- Nationwide we process 1.7 billion litres of milk annually at our 10 dairy manufacturing sites
- We produce a range of high quality dairy ingredients for export, such as specialty milk powders and dairy fats and proteins, as well as branded products for domestic consumers and foodservice operators.
- Our Australian operations leverage Fonterra's integrated global supply chain and export more than 131,000 tonnes of dairy products annually.
- Exports to key markets such as China, Japan and South East Asian countries represent over 23 per cent of Fonterra's Australian sales.

Fonterra's strategy for the future involves increasing the value and volume of our exports from Australia to international markets where there is growing demand for quality dairy nutrition. This strategy has already seen strong results and continues to be the guiding force behind Fonterra's growth. It is supported by major investments in manufacturing infrastructure, our international marketing network and sales channels, and innovation and product development.

Our Tasmanian operations are a key part of our wider network and we take a keen interest in the development of the dairy industry in the State. Therefore we are pleased to be able to share our views on the development of dairy exports to Asia in particular.

We believe the Tasmania Government can play a strong role in supporting the growth of exports generally, and dairy specifically, to Asia by putting in place the right regulatory conditions, infrastructure and financial support for food

manufacturers, so that processors can become more competitive and focus on the production of high-value, high-demand products.

2.1 What are the key opportunities for Tasmania from the growth in Asian economies?

From a dairy perspective, the opportunities presented by Asian growth are significant. Continued GDP growth and associated urbanization is expected to deliver three billion more middle class consumers in the Asia Pacific region alone by 2030. This rapid rise has reshaped world dairy trade flows in the past few years, and has set the tone for the next decade ahead.

China has now become the single largest dairy importer in the world. In addition to economic drivers, changing dietary patterns have contributed significantly to this rapid growth. There is growing recognition of the role of dairy nutrition in China as part of a healthy, balanced diet. An increased focus on health and wellness among consumers is evident and interest in consumer products that support health and wellness is growing rapidly. Some of Fonterra's strongest brands – Anchor, Anlene, and Anmum – have all had incredible growth and success in China and indeed across Asia.

With increasing urbanisation, there is also a strong trend to Westernisation of diet, and a lifestyle that values taste and convenience. Forty per cent of people in urbanised China now eat at a Western fast food outlet once a week. These trends are strongly in place and will continue to grow.

Per capita consumption of dairy is projected to continue to grow, and the upside is huge. The average Chinese consumes less than the equivalent of 10 litres of milk each year, compared to a developed Asian economy such as Japan at around 50 litres, and levels around 100 litres a year in Britain and here in Australia.

Many other countries in South East Asia will also enjoy similar consumption growth rates in the years to come. In fact, to meet projected demand growth the world will need milk supply to grow by the equivalent of **1 to 2 times** Australia's total annual production **each** year.

While the past two years has seen an expansion in supply in all major exporting regions around the world, this has never historically continued in a consistent and repeating pattern across this diverse group of geographies and farming systems. It is both a major challenge and opportunity.

It is widely expected that all dairy producing countries will play a role over the next decade in meeting this projected demand, and that the most significant among these will be those with lower-cost farming systems.

Traditionally Australia and New Zealand have been advantaged in this regard over most northern hemisphere producers due to a combination of lower-cost, pasture based production systems, and superior rates of productivity improvement.

Whilst this is likely to continue, rising input costs across all producing countries in the form of feed-grain costs, fertiliser costs, energy and water costs, and finance costs are having an influence at the country and regional levels on the settings to encourage production growth.

Therefore, we encourage the Tasmanian government to help maintain a lower-cost dairy production base in the state by:

- Fonterra supports compliance with the highest environmental outcomes. However regulatory uncertainty, inefficiency and high-cost operating structures are currently present in a variety of sectors, including power and water. These factors can act as a significant impediment to on-going industry investment in Tasmania. We would encourage the Tasmanian Government to put in place the right regulatory conditions, infrastructure and financial support for food manufacturers, so that processors can become more competitive and focus on the production of high-value, high-demand products.
- Ensuring **energy prices** in Tasmania are competitive and that the performance and operations of energy regulators and suppliers in Tasmania is as efficient and cost-effective as possible. Regulatory inefficiency and high-cost operating structures are a barrier to investment in Tasmania for both dairy farmers and processors.
- Fair and equitable **access to irrigation water** for farmers is necessary for the growth and development of Tasmania's dairy sector. Irrigation water allocation mechanisms need to be transparent and equitable and mechanisms are needed to minimise the impacts of water speculators. Any actions that withhold water availability may increase water prices and impede dairy industry development.
- Farm **conversion approvals processes** may be presently impeding the timely entry of new dairy farmers, and therefore potentially delaying investments in plant expansions. Significantly greater milk volumes are required to justify major plant expansions and farm conversions (to dairy) are critical to increase Tasmania's milk supply. However, the processes farmers need to go through are slow and complicated. The Tasmanian Government needs to improve the speed of conversion approvals processes. Fonterra has considerable global experience in managing the impacts of dairy on the natural assets and we are keen to bring our expertise to Tasmania to ensure the conversions are done properly and the approval process is efficient.

2.2 Are Asian market opportunities for Tasmania sustainable?

We believe that dairy has a particularly strong ability to build sustainable exports to Asia from Tasmania due to the many natural and climatic advantages that Tasmania offers as a dairying region.

However, it is important that dairy farmers and processors are given confidence to start building their milk volumes with the right signals and support from Government, as outlined in our responses to questions 2.1 and 2.4.

2.4 Should Tasmania focus on accessing Asian opportunities broadly, through capabilities, or by targeting specific markets and export products and services?

As export opportunities grow and competition increases in different sectors, the onus will be on food producers to move their production up the value chain in order to capture the highest possible value from the export market.

To do this, manufacturers will need to invest in plant flexibility and capability. Therefore, we believe the government can best support access to Asian opportunities for the dairy sector specifically by putting in place the right regulatory conditions, infrastructure and financial support that will enable manufacturers to remain competitive and value-focused.

Looking specifically at the dairy industry, in addition to the points outlined in response to question 2.1, Fonterra sees several other issues that should be addressed to access Asian opportunities:

- For the on-going growth and sustainability of Tasmania's dairy sector, it is important Fonterra has **long term planning certainty** (land use zoning) so that our processing plants have room for future expansion and cannot be encroached upon by urban residential development.
- The **proposed Food Standards Australia New Zealand (FSANZ) health claims standards** will impact the international competitiveness of the dairy sector and significantly inhibit innovation. Fonterra's on-going investment in innovation could potentially be halved as a result of these standards.

4.11 Do you agree with the assessments on capacity for the sectors identified?

Fonterra agrees that constraints exist in the dairy processing sector in Tasmania. Fonterra also agrees the potential for dairy expansion is linked to the viability of processors to invest and that recent substantial investment in processing has provided opportunities for the dairy sector to expand.

Fonterra has a track record of investing over time to build a platform for the future growth and development of Tasmania's dairy sector, even in face of price volatility. In the last two years we have invested over \$17 million in our two Tasmanian sites. With the right conditions over the next two years, Fonterra may invest another \$20 million into our two sites in Tasmania. These two sites employ 90 people and collect over 500 million litres from almost 300 dairy farms each year and last year we paid our Tasmanian supplier \$235 million for their milk.

Our investment platform for future growth will make sure we have the flexibility to produce a range of products and move our products up the value chain in order to capture the highest possible value from the domestic and export markets.

Fonterra wants to fill our capacity in Tasmania, and across our manufacturing base, to fully utilise our production capability and realise the investments we have made for future growth in exports and up the value chain. There is potential for Fonterra and the dairy industry in Tasmania. However, this has been recently hampered by regulatory challenges and we look forward to further discussions with the Tasmanian Government as to how these may be resolved.

4.12 What are the priorities for investment in increasing capacity in the sectors?

A focus from the Tasmanian Government on enabling infrastructure and competitiveness measures will make Tasmania more attractive for international capital investment. We have outlined specific areas to focus on in response to questions 2.1 and 2.4.

4.13 What do you believe is the role of governments in general in facilitating opportunities arising from the Asian Century?

We believe the Tasmanian Government can play a strong role in supporting the growth of exports generally, and dairy specifically, to Asia by putting in place the right regulatory conditions, infrastructure and financial support for food manufacturers (as outlined in response to questions 2.1 and 2.4), so that processors can become more competitive and focus on the production of high-value, high-demand products.

4.22 What opportunities does your organisation see in the next phase of Asian growth?

Fonterra's strategy for the future involves increasing the value and volume of our exports from Australia to international markets where there is growing demand for quality dairy nutrition. This strategy has already seen strong results and continues to be the guiding force behind Fonterra's growth. It is supported by major investments in manufacturing infrastructure, our international marketing network and sales channels, and innovation and product development.

Fonterra wants to fill our capacity in Tasmania, and across our manufacturing base, to fully utilise our production capability and realise the investments we have made for future growth in exports and up the value chain. There is potential for Fonterra and the dairy industry in Tasmania. However, this has been recently hampered by regulatory challenges and we look forward to further discussions with the Tasmanian Government as to how these may be resolved.

We believe the Tasmania Government can play a strong role in supporting the growth of exports generally, and dairy specifically, to Asia by putting in place the right regulatory conditions, infrastructure and financial support for food manufacturers, so that processors can become more competitive and focus on the production of high-value, high-demand products.

Conclusion

Fonterra thanks the Department of Premier and Cabinet for the opportunity to comment on this paper and we look forward to the outcomes and recommendations from this work. We would welcome further discussions with Government on the issues we have highlighted in our response.

Sincerely ,

Simon Bromell

Managing Director
Fonterra Ingredients Australia