



Advancing Australian agriculture in partnership with Asia

The good times can be even better

ABARES Outlook Conference
6 March 2018

Doug Ferguson, Partner in Charge,
Asia and International Markets



March 2018

Regional economic and demographic demand drivers

Australia’s agricultural future is now well and truly connected to global and Asian markets and will remain so for many decades, if not forever.

In 2015, eight of Australia’s top ten agricultural export markets are in Asia, including China as the largest followed by Japan (3), Indonesia (4), and the Republic of Korea (5); and 62 percent of our agriculture exports go to these Asia countries and most markets are now covered by FTAs.¹

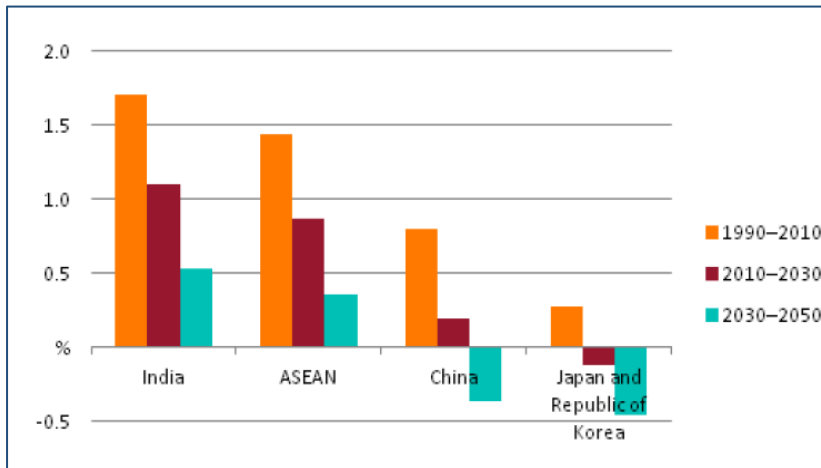
Demographics and economics will continue underwrite the Australian food industry’s pivot to Asian markets.

By 2050, the earth’s population is projected to reach over 9 billion. That’s another 1.4 billion people, equivalent to 1.8 times Australia’s current population each year for the next 32 years. India, China and ASEAN will be key drivers of this frightening reality.²

ANZ predicts 85 percent of the growth in the world’s growing middle class is expected to be in Asia.³

The population of most key Asian countries is expected to grow toward 2050, although at a declining rate. China’s population is projected to peak at 1.4 billion in 2026, before declining to 1.3 billion by 2050. India’s population is projected to increase from 1.3 billion today to 1.7 billion by 2050 and the population of the ASEAN member states in total is projected to increase from 625 million today to 756 million in 2050. (ABARES).⁴

Asian population growth⁵



The Food and Agriculture Organisation of the UN (FAO) predicts food supply will need to increase 60 percent to meet global demand. This rate of growth equates to an additional 70 million people for agriculture to feed every year.⁶

The OECD’s Agricultural Outlook for 2017-2026 predicts a slowdown in agricultural production growth in Asia over the next decade compared to the previous decade.⁷ Food security is a real concern for

¹ DFAT STARS Database, June 2016 data; ABS Special Data Service.

² UN FAO, ‘Global Agriculture towards 2050’, Rome Expert Forum; UN FAO, ‘The State of Food Security and Nutrition in the World’, 2017.

³ ANZ, Greener Pastures: The Global Commodity Opportunity for Australia and New Zealand, 2012.

⁴ ABARES, ‘What Asia wants, Long-term food consumption trends in Asia’, 2013.

⁵ ABARES, ‘What Asia wants, Long-term food consumption trends in Asia’, 2013.

⁶ UN FAO, ‘Global Agriculture towards 2050’, Rome Expert Forum; UN FAO, ‘The State of Food Security and Nutrition in the World’, 2017.

⁷ OECD-FAO, ‘Agriculture Outlook 2017-2026, Special Focus: Southeast Asia’ 2017.

Asian governments and beyond the obvious humanitarian reasons. Hungry stomachs and rapid inflation can lead to mass social unrest.

Whilst food production in Asia is expected to increase, self-sufficiency in core food staples remains an unattainable goal for many governments. ABARES projections indicate that production growth will not be sufficient to meet the growth in food consumption for commodities other than rice.⁸

That's a key reason why the Chinese Government is so vigorously pursuing the Belt & Road Initiative – to access vast food and resources regions in central Asia and Eastern Europe. It also explains why developing or acquiring agtech and implementing the technology on scale in remote farming regions is such a priority for both the Chinese and Indian governments.

Food and agtech will play a major role as Asian governments, including China are planning for more plant based proteins to be eaten as a substitute for meat protein.

In order to meet this new and changing demand, there will be a need for Asia to significantly increase food imports to complement domestic production.

Australia is well positioned to benefit, but the competition is intense. For example, Brazil gained access to the Chinese beef market in May 2015, and surpassed Australia's exports to the market in December 2015.⁹ The US beef export re-entry to China will surely intensify this competition, although the current state of relations between US and Chinese governments, who are threatening trade war, could delay or reduce this competitive risk.

Interestingly, competition from Russian and Ukrainian producers in the Black Sea region has also pushed into the South East Asian market with cheaper exports and Argentina is also quickly growing market share.

What is Australia's advantage in the global market in the eyes of Asian consumers?

There are many factors that contribute to Australia's competitive advantage including:

- Australia's brand as a clean, green and healthy food producer of fresh and high quality food (underwritten by strict bio-security regulations).
- Proximity to Asia allows relatively faster export of perishable goods as well as export of higher value goods (although as will be discussed, this should be much faster).
- Counter-seasonal production capacity that avoids direct competition from the US and Canada for some goods, however not against South American and other Southern Hemisphere competitors.
- Australia is becoming a very large and popular inbound tourist destination for over 1.5 million wealthy Chinese annually as well as many Indians and other Asian nationals.¹⁰ They are visiting Australia, tasting and enjoying our delicious fresh food and wine and wanting to buy more of it back in their home supermarkets or online through e-commerce channels.
- 26 years of continuous economic growth and transparent regulations make Australia attractive for Asian investors and traders.

Current export outlook: What do the numbers tell us?

According to ABARES, Australian farm exports were valued at \$44.7 billion in 2015–16, \$45 billion in 2016–17 (Austrade) and are forecast at \$48.7 billion in 2017–18.¹¹

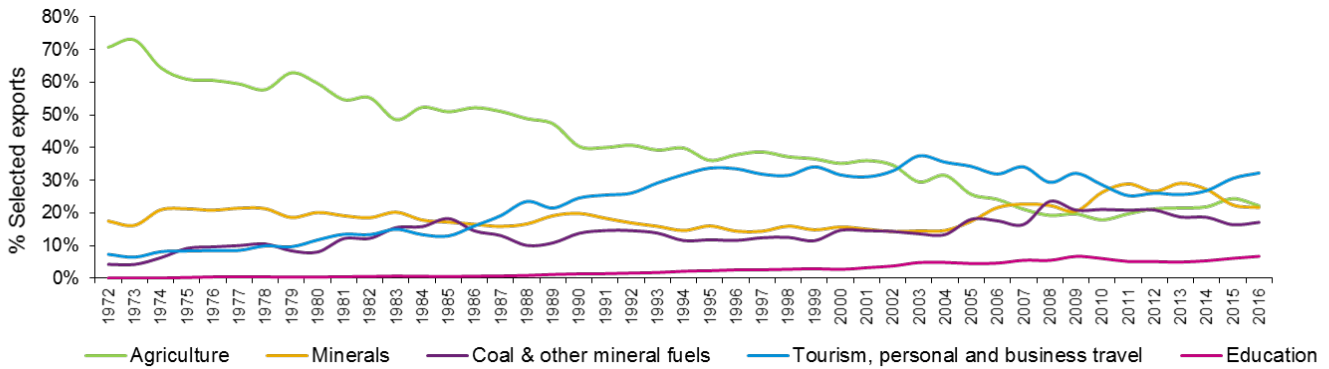
⁸ ABARES, 'What Asia wants, Long-term food consumption trends in Asia', 2013.

⁹ ABARES, 'South America: an emerging competitor for Australia's beef industry', 2016.

¹⁰ AUSTRADE & Tourism Research Australia, 'International Visitors in Australia', 2017.

¹¹ DFAT, 'Composition of Australian Trade 2016-17', 2017; ABARES 'Agriculture Commodities' 2017.

Composition of Australian exports¹²



The green line on the graph above shows that, except for tourism which in 2016 was an AUD 53 billion industry and growing at 7.4 percent per annum, agriculture has returned to being a leading export driver for Australia and has experienced solid growth in the past decade.¹³

The NFF predicts the value of Australia’s agriculture sector will almost double in the next 15 years, creating Australia’s next AUD 100 billion industry.¹⁴

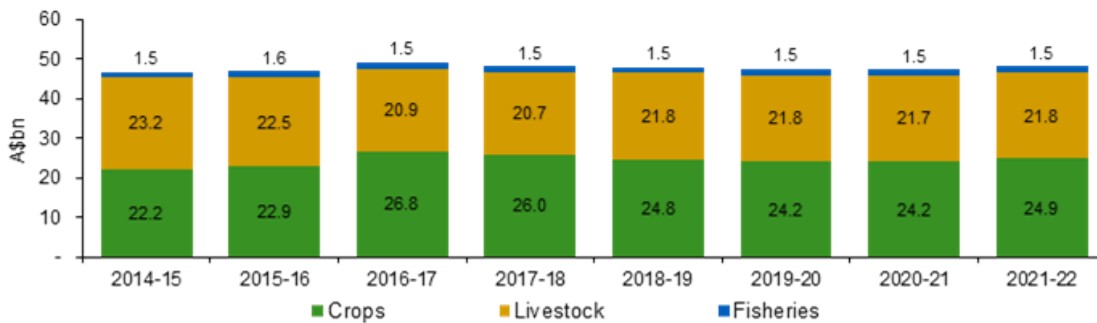
Can we achieve this and how will we do it?

One of our most important medium term challenges to address at the 2018 ABARES Outlook conference must surely be to answer this AUD 100 billion dollar question and in doing so, extend the recently experienced good times for the next generation of Australian food producers.

I believe the nearly 90,000 Australian farming companies / farmers are very hard working, innovating and doing their best with the factors of production currently available and in the harsh climates they work with.

Despite the hard work of all industry participants, ABARES export statistics show that we are not making enough ground, fast enough to be a major competitor in this Asian food industry.

Australian agriculture exports¹⁵



¹² Australian Bureau of Statistics database, ‘International Trade’, 2017.

¹³ Austrade, Australia’s export performance FY2017, 2017.

¹⁴ KPMG et al. ‘Powering Growth’ 2016.

¹⁵ ABARES ‘Agriculture Commodities’ 2017.

Let's look at the present production outlook based on ABARES statistics:

- Total volume of farm production is forecast to fall by 5.6 percent in 2017–18, following record production in 2016–17.¹⁶ Assuming average seasonal conditions, farm production will slowly rise over the medium term to 2021–22, when it is projected to exceed the 2016–17 level.
- Export prices are forecast to increase by 2.8 percent in 2017–18, as reflected in the Australian farm exports unit returns index.¹⁷
- Towards 2021–22 the assumed lower Australian dollar and forecast decline in world prices of many agricultural products will lead to a projected decline in the unit returns for farm exports, in real terms according to ABARES.¹⁸

More specifically, when we look at the export profile of our core agricultural products:

Crops

- Export earnings for crops are forecast to fall to around AUD 26.5 billion in 2017–18 from a forecast AUD 26.8 billion in 2016–17.¹⁹
- Export earnings are forecast to decrease in 2017–18 for wheat (down 9 percent), coarse grains (down 11 percent), canola (down 6 percent) and chickpeas (down 42 percent).²⁰

Livestock

- Export earnings for livestock products are forecast to rise slightly to AUD 22.2 billion in 2017–18, Beef (up 1 percent), dairy (up 11 percent), wool (up 10 percent), lamb (up 3 percent), live feeder/slaughter cattle (up 4 percent) and mutton (up 1 percent).²¹

These are hardly aggressive or ambitious growth numbers and we need to ask why?

In the context of Asia:

- Is there a fundamental lack of understanding, knowhow and relationships with Asian counterparties to grow exports?
- Is it because of the complexity and difficulties of exporting products to key developing Asian countries where technical non-tariff barriers are a constant challenge and where competition is becoming more intense?
- Is it because our production and processing lacks the scale to meet the increasing demands of Asian consumers and investors?
- Is the under-investment in critical rural regional transport and water infrastructure resulting in higher product export costs and delaying the speed of our perishable food exports?
- Is it because we lack unified and recognisable export brands for our foods in Asian markets and insufficient co-ordination to promote Australian branded foods?
- Or is there complacency about Australia's assumed right to become the food bowl or deli of Asia when other countries are more aggressive?

¹⁶ ABARES 'Agriculture Commodities' 2017.

¹⁷ Ibid.

¹⁸ Ibid.

¹⁹ Ibid.

²⁰ Ibid.

²¹ Ibid.

I personally believe all of these factors are negatively impacting Australian agriculture to varying extents. Some of these issues are of our making, some are not - but we have to jointly work harder to manage, if not resolve them.

Key market insights for China, Indonesia and India

Before we start thinking about how to solve these challenges, it's useful to revisit the dynamic outlook for our high growth Asian export markets, especially China and Indonesia to remind ourselves of the specific opportunities and specific country challenges.

If we attended the ABARES conference 5-10 even 15 years ago, I am sure someone like me would have shared incredibly attractive forecast Asian market export sales projections. However what has changed since then is that China's potential has become a reality in terms of scale and diversity of food import demand, driven by massive shifts towards westernised diets afforded by urbanised, middle income consumers with brand driven and e-commerce buying habits.

While Japan, Korea remain strong, mature and important high value markets, given the ageing demographics and anaemic economic growth expectations, they don't offer the same high growth potential as China and Indonesia.

The other Asian markets largely in the ASEAN region (Indonesia, Malaysia, the Philippines, Singapore, Thailand, Brunei, Vietnam, Laos, Myanmar and Cambodia) are expected to grow but from a relatively small base with the exception of Indonesia and Singapore which remains a stable and reliable food export market and an important platform for Asian exports for Australia.

ASEAN region, with a population of approximately 600 million, is expected to witness food demand increase by as much as 40 percent by 2050.²² Regional integration is expected to see South East Asia's exports increase by 15 percent creating as many as 4.5 million jobs by 2025 according to the World Economic Forum, May 2016.²³

China is still the main prize

The OECD estimates that China will overtake the USA with the world's largest middle class population by 2020.²⁴ China will become the world's largest economy, overtaking the USA at about the same time. China must continue to be our major country focus for driving food export growth.

China is a leading agricultural producer and announced in 2014 a 'push for absolute food security'. In 2016 China's government announced that it intends to be 95 percent self-sufficient on domestic agricultural production of wheat, cereal and rice.

The rise in agricultural food consumption is largely being driven by the continuing urbanisation of the Chinese population. Urban Chinese incomes were roughly three times (2.72x) higher than rural incomes in 2016 and the percentage of the population living in urban areas increased from 44 percent in 2006 to 57 percent just 10 years later in 2016.²⁵

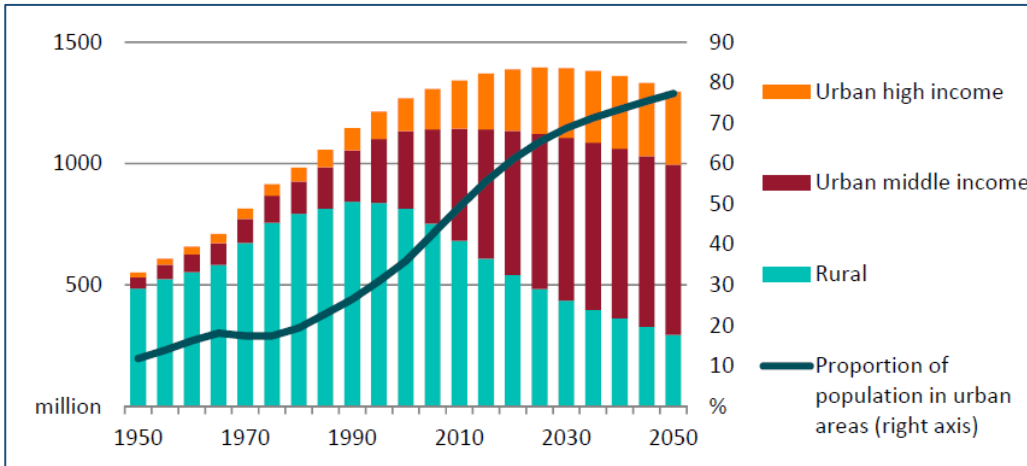
²² ABARES, 'What Asia wants, Long-term food consumption trends in Asia', 2013.

²³ Tania Strauss, 'The secret to food security in East Asia', World Economic Forum, 2016.

²⁴ EGA, 'Driving Growth in Emerging Markets', Emerging Global Advisors 2015.

²⁵ ABARES, 'What China wants: Analysis of China's food demand to 2050', 2014.

China's population (urban vs rural)²⁶

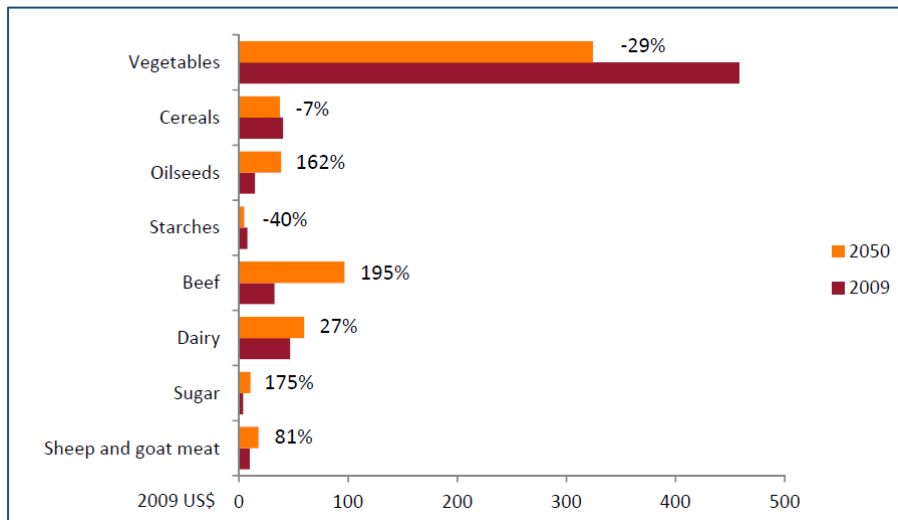


The rise in food consumption in China is now characterised by more westernised diets with much higher relative intakes of high-value protein rich foods, such as dairy products, beef, sheep and goat meat, fruit and vegetables, and lower intakes of starchy staples. This will accelerate towards 2050.

Between 2009 and 2050, the real value of beef consumption in China is projected to rise 236 percent, dairy consumption 74 percent, sheep and goat meat consumption by 72 percent and sugar consumption by 330 percent (in US dollars), albeit all from a relatively low base.²⁷

Meanwhile, there has been a major pivot in the past five years with the Chinese government seeking to significantly replace meat with plant based proteins. There is also a lot of focus on urban vertical farming and cropping methods.

China's urban agricultural consumption (ABARES)²⁸



Beef

China's beef import market is expected to reach a staggering USD 10 billion in 2050, but international competition and local technical non-tariff regulations are serious challenges for Australian exports.²⁹

²⁶ ABARES, 'What China wants: Analysis of China's food demand to 2050', 2014.

²⁷ ABARES, 'What China wants: Analysis of China's food demand to 2050', 2014.

²⁸ ABARES, 'What China wants: Analysis of China's food demand to 2050', 2014.

²⁹ ABARES, 'What China wants: Analysis of China's food demand to 2050', 2014.

For example in October 2017, China lifted a ban on six frozen beef exporters that had been in place for 3 months. The ban was implemented in the middle of negotiations to implement protocols for Australian chilled beef and offal exports to China and Chinese prawn exports to Australia. The ban cost an estimated AUD 1 million a day before being resolved.³⁰

Australian beef exporters were celebrating when a joint government statement announced in 2017 that chilled beef would be allowed to be imported into China. This was premature. Since then, none of the required protocols for import of Australian chilled beef and beef co-products have been resolved and Australia is waiting on the Chinese regulators to provide some direction for conclusion.

At the same time, USA, Brazilian and Argentinian chilled beef is taking advantage of this chilled beef sector, albeit with only limited tonnage to date. They will need to go through a similar import protocol process, however the potential to take this market from Australian exporters is real.

Dairy

The real net value of China's dairy imports in 2050 is projected to be around USD 7 billion.³¹ China has emerged as a large, global importer of milk powders and several Australian companies are benefitting but technical non-tariff barriers are also a major problem which impacts all foreign competitors and often requires the involvement of industry and Department of Agriculture representatives domestically and in-market. Due to the scale of emerging technical non-tariff barriers in dairy, industry participants describe the current phase as one of management, rather than focusing on growth.

For example, Australian infant formula establishments need to be approved with a CNCA license registration by Chinese government regulators and following this, their individual brands require separate approvals through a separate Chinese agency called the CFDA. This is a result of valid concerns in China on product quality following the tragic melamine scandal some years ago. This convoluted licensing and registration process has been very problematic, causing sudden and acute pain for some listed Australian dairy companies. Australia has the most dairy company establishments registered however and all foreign companies are impacted.

Fisheries

China is the world's largest producer and the world's largest exporter of fisheries products. China is negotiating for Australia to agree protocols for the importation of farmed fisheries products in exchange for Australian exports of chilled red meats (i.e. a two-way trade deal).

However China is also the third largest importer, with imports of USD 8 billion in 2012.³² Australia's export earnings are forecast to rise for rock lobster (up 6 percent) largely as a result of strengthening demand from China.³³ This is now driving lots of Chinese inbound investor interest in Australian aquaculture. Like beef and dairy, Chinese investors want to invest and participate or even control the value chain.

Services

Beyond food exports, another area in which Australia is highly suited to working with Chinese farmers is water management services. At least 60 percent of China's groundwater is now heavily polluted. Australian knowledge of bio-chemicals to reduce water pollution, water efficient crop strains, polluted water decontamination and water resources management are of clear use to China.

Australia has over 300 agtech businesses with some world class solutions that can and are being exported to China.

³⁰ ABC Rural, 'China lifts Australian beef import suspension from six major firms', 31 Oct 2017.

³¹ ABARES, 'What China wants: Analysis of China's food demand to 2050', 2014.

³² Ibid.

³³ ABARES 'Agriculture Commodities' 2017.

Increased exports of red meat, dairy, fruit and vegetables and wine, delivered faster and more efficiently than our international competitors to Chinese consumers is the shared goal for Australian governments, our industry representative bodies and our producers and processors.

China is not easy. We've had China Australia Free Trade Agreement ChaFTA for just over two years now and while tariffs are being reduced in line with agreements, non-tariff barriers including product import licensing, physical port and quarantine processing (as well as cold chain logistics and storage infrastructure) remain a major concern for many Australian exporters and must be constantly managed and addressed.

Indonesia has enormous export potential

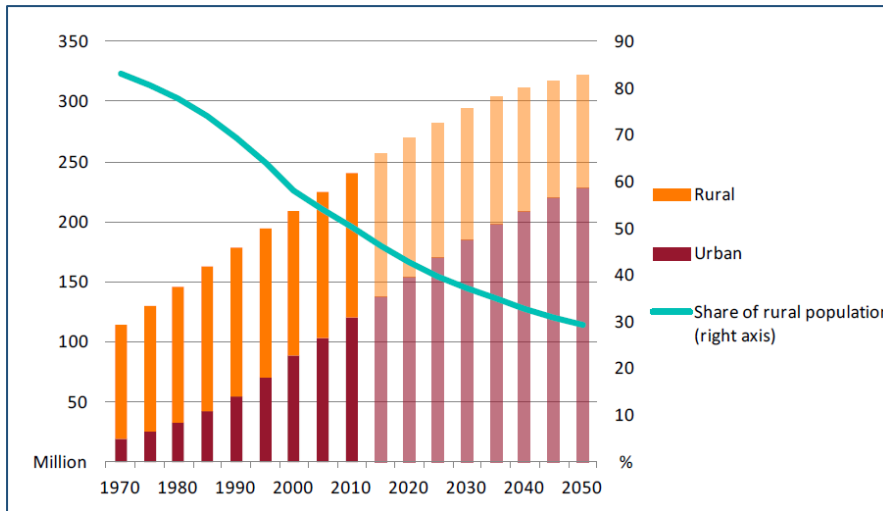
In 2016-17, Australia was the second-largest exporter of agricultural products to Indonesia, behind the United States. Australia supplied around USD 2.5 billion of agricultural commodities (excluding tobacco and its products), compared with USD 680 million in 2000 (in 2014 US dollars). Australia is the leading supplier of beef to Indonesia followed by New Zealand.³⁴

Indonesia's population has grown quickly in past decade to reach 265 million people, an average growth rate of 1.4 percent a year. The population is expected to grow by almost 60 million people to reach 322 million in 2050.³⁵

Indonesia has a young population. Almost half of the population is aged under 30 years and this is expected to fall to 41 percent by 2050.³⁶

The gradual rise of the Indonesian middle class means the transition in consumer preference has been slow and price sensitive. Boston Consulting Group estimates that the middle and affluent class currently stands at 74 million individuals, expected to rise to 140 million by 2020. McKinsey estimates that average consumer spending growth of 7.7 percent will continue to 2030.³⁷

Indonesian population (rural vs urban)³⁸



Indonesia has a comparative advantage in the production of non-food, cash crops, such as natural rubber, copra, palm kernels, coffee, cocoa and spices.³⁹ The production of these cash crops

³⁴ Austrade, 'Industries: Export markets – Indonesia', <<https://www.austrade.gov.au/australian/export/export-markets/countries/indonesia/industries/agribusiness>> 2018.

³⁵ ABARES, 'What Indonesia wants: Analysis of Indonesia's food demand to 2050', 2015.

³⁶ Ibid.

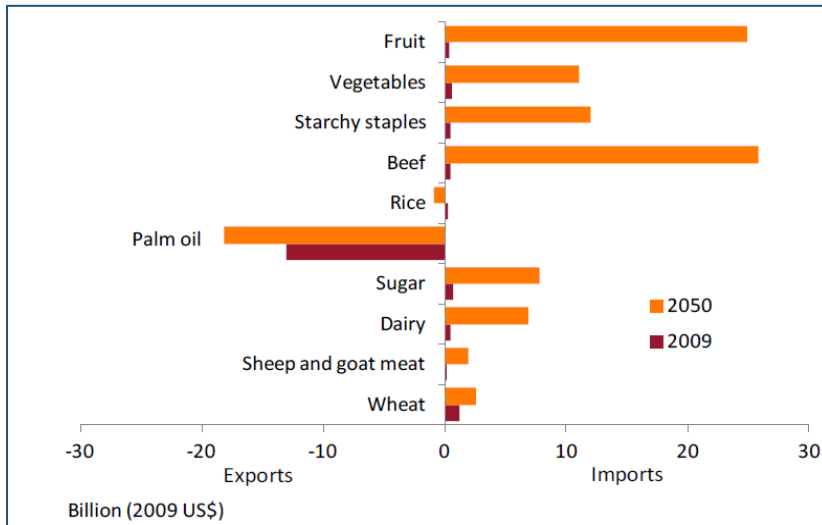
³⁷ McKinsey & Co., 'The evolving Indonesian consumer, 2014.

³⁸ ABARES, 'What Indonesia wants: Analysis of Indonesia's food demand to 2050', 2015.

³⁹ ABARES, 'What Indonesia wants: Analysis of Indonesia's food demand to 2050', 2015.

competes with food crops for resources, despite Indonesia's policies that support food production and food self-sufficiency.

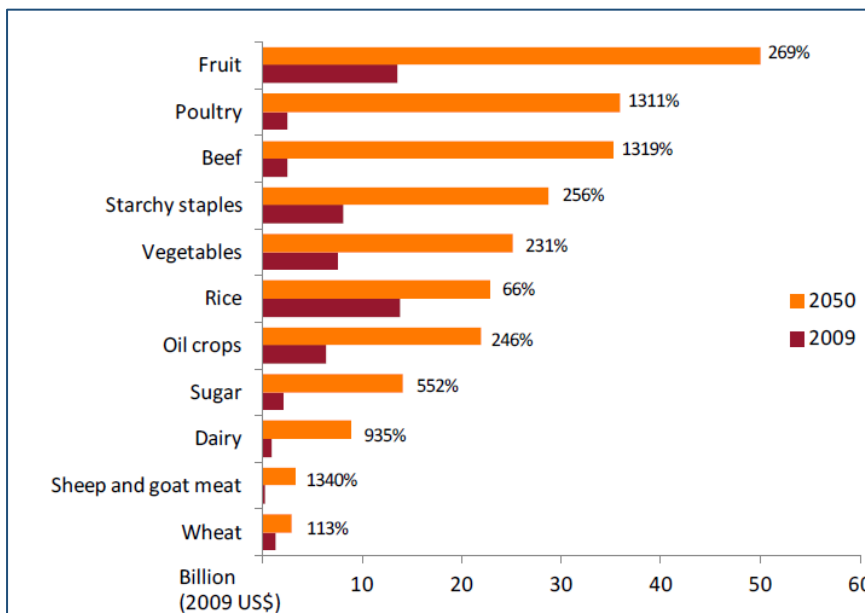
Indonesia import / export balances⁴⁰



According to ABARES, per capita beef consumption is projected to rise more than nine times in the four decades to 2050; dairy more than seven times; and fruit and vegetables to more than double. Consumption of rice is projected to fall by 4 percent.⁴¹

Given a largely Muslim population, Halal certification is a critically important import and production standard that the Indonesian regulatory authorities are increasingly enforcing, including for foreign companies who have invested and are operating in the country. This even applies to products like vitamins and health supplements.

Indonesia agricultural consumption (ABARES)⁴²



⁴⁰ ABARES, 'What Indonesia wants: Analysis of Indonesia's food demand to 2050', 2015.

⁴¹ ABARES, 'What Indonesia wants: Analysis of Indonesia's food demand to 2050', 2015.

⁴² ABARES, 'What Indonesia wants: Analysis of Indonesia's food demand to 2050', 2015.

Yet the growth statistics for Indonesian food imports are huge:

- In 2050, imports of beef are projected to reach USD 26 billion, compared with USD 0.5 billion in 2009.⁴³
- Imports of dairy products are projected to be USD 7 billion in 2050, compared with USD 0.4 billion in 2009.⁴⁴
- For fruit and vegetables, the value of imports is expected to increase by almost USD 25 billion and USD 11 billion (in 2009 US dollars), respectively, between 2009 and 2050.⁴⁵

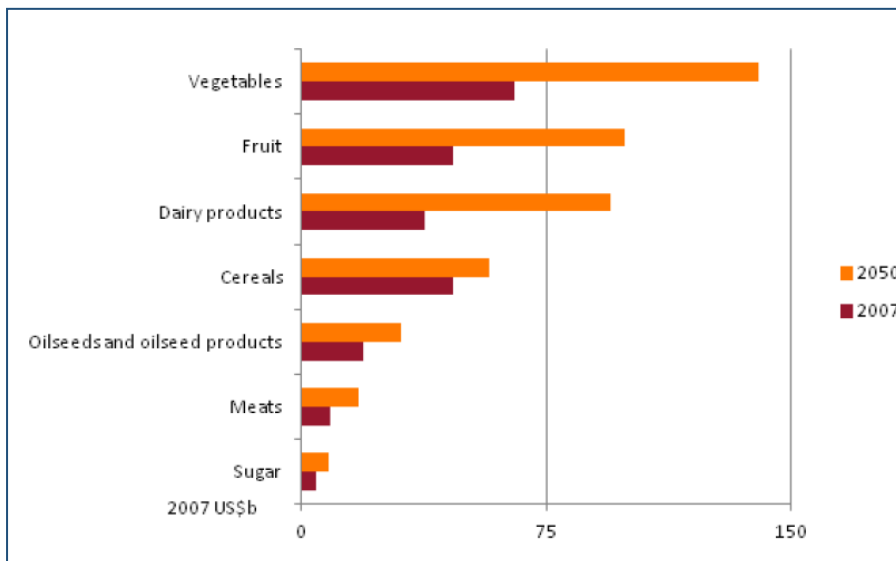
Investing and operating in joint ventures in Indonesia is very difficult and requires very careful planning and execution. Major policies can be suddenly announced and applied retrospectively for foreign companies. For example, recently in the dairy sector foreign importers or processors were advised to demonstrate how they are helping to build the domestic Indonesian dairy industry.

India

India receives lots of media interest because the size of its population of 1.286 billion which accounts for 17.5 percent of the world’s population and is growing fast. India’s economy, under the Modi government, grew by an estimated 7.5 percent in 2016 and is assumed to maintain similar growth in 2018.

However, India is not a high growth agricultural export market for Australia in the near or medium term. India is a major global food and dairy producer and exporter itself, particularly in rice, coarse grains, fruits and vegetables and aquaculture. The government plays a major role in the development and operation of, and investment into, the agriculture economy and sets high import tariffs.

Indian agricultural consumption (ABARES)⁴⁶



Given the dominant Hindu religion, beef is not imported in any scale while wheat imports are starting to increase and may become a USD 1.5 billion export market by 2050.

India often supplements its protein requirements with dairy products making it the largest consumer of dairy products in Asia. In 2050 India is projected to remain the largest consumer of dairy products in

⁴³ Ibid.

⁴⁴ ABARES, ‘What Indonesia wants: Analysis of Indonesia’s food demand to 2050’, 2015.

⁴⁵ Ibid.

⁴⁶ ABARES, ‘What India wants: Analysis of India’s food demand to 2050’, 2014.

Asia, with the real value of consumption at USD 95 billion—more than double compared with 2007.⁴⁷ The expected growth of the Indian middle class is likely to drive the demand for manufactured dairy products.

Dairy has potential to become a major export opportunity in India, but over the longer term. Australian sheep meat and goat meat also has potential if appropriate tariff agreements can be negotiated. India remains a leading cotton and wool spinning / weaving producers so an important target market for Australian cotton and wool.

From a services perspective – agtech, water management and sustainable production services are priorities of the Indian Government and are of interest to Indian investors in Australia.

Taking greater advantage of current free trade agreements and anticipating what lies ahead

Our Federal Government, under former Trade & Investment Minister Andrew Robb, delivered bilateral free trade agreements with China, Japan and South Korea. Trade, Tourism and Investment Minister Steven Ciobo has led further FTA initiatives with Singapore successfully concluded while Hong Kong and Indonesia are in play. All key Asian agricultural export markets except Indonesia, India are now covered by bilateral or multi-lateral FTAs.

The Indonesia Australia Closer Economic Partnership Agreement (IA CEPA) is still being negotiated but has been delayed. One of the goals for Indonesia is to encourage Australian and Indonesian companies to create jointly owned and managed food manufacturing and packaging companies in Indonesia, to process and package Halal certified food for domestic Indonesian population as well as for ASEAN export markets.

Free trade agreement negotiations between Australia and India stalled in mid-2016 due to a number of major disagreements. There is no sign of this changing at present. The lack of a bilateral agreement has left bilateral trade for all industries stagnant at AUD 20 billion compared with circa AUD 150 billion with China.

The newly named 'Comprehensive and Progressive Agreement for Trans Pacific Partnership' (CPTPP) with 11 countries – presently excluding USA and Canada – is presently expected to be signed in Chile in March 2018 and then it needs to pass through our Parliament.

Whether the USA will join TPP remains unclear but unlikely in March. President Trump was very firm that they were permanently withdrawing but more recently at Davos 2018, he re-opened the possibility. The US is focused on NAFTA, a bilateral agreement with Japan and upgrading their existing Korea FTA.

CPTPP tariff reductions will take a long while to kick in - as long as 10 years. While the Federal Labour opposition calls for greater transparency and economic modelling on the impacts of CPTPP, based on what we've been told, it appears that our farmers will benefit in terms of increased export volumes for beef, sugar, rice, dairy, wheat, wine and seafood.

Dairy and wheat exports into Japan stand out as great CPTPP opportunities for Australia (assuming the USA is not a CPTPP member), but technical tariff and non-tariff matters and competition will remain challenging in Japan.

CPTPP is important, however Australia has bilateral FTAs with most members, including most recently Peru.

The 'Regional Comprehensive Economic Partnership' (RCEP) has been under negotiation by ten ASEAN members and six other regional countries (including Australia, New Zealand, China, Korea and India) since 2012 and there is very little transparent progress after 22 rounds of negotiations. India and China are debating key issues.

⁴⁷ ABARES, 'What India wants: Analysis of India's food demand to 2050', 2014.

RCEP is running separately to CPTPP and it remains important for Australian agriculture to be a member because nine out of our top 13 trading partners are in the RCEP, accounting for 65 percent of total Australia good and services exports. To enable to access to the RECP tariff and non-tariff benefits, Australia needs to be inside the RCEP production and value chain region.

Australia meanwhile already has an existing regional FTA with ASEAN and NZ - AANZFTA.

Last week, Minister Ciobo that The Department of Foreign Affairs and Trade (DFAT) and PWC had released a FTA utilisation report showing 77 percent of large enterprises with over 200 employees use FTAs compared to 55% of small to medium size enterprises (SMEs)⁴⁸.

Improving awareness, understanding and utilisation rates usage of FTAs remains a challenge for Australian SME exporters and the Federal Government. A survey by the Economist Intelligence Unit revealed in 2015 (so before the implementation of the new trifecta of China, Japan and South Korea FTAs) that Australia's FTA usage rate was only 19 percent (i.e. less than 20 percent of exporters are taking full advantage of the FTAs) and KPMG estimated in a 2016 report this is costing us at least AUD 14 billion of export trade revenues over the next 5 years.⁴⁹

It is therefore very positive to see that utilisation rates for both larger and SMEs in Australia is improving thanks to concerted efforts by government agencies including Austrade.

There is no doubt a lot of complexity in these extremely detailed and over-lapping FTAs for Australian SME food companies with insufficient experience and resources to understand and take full advantage of what is on offer. They need help.

KPMG has launched 'Access Asia', a comprehensive trade consulting services business to address a wide variety of key challenges being faced by Australian exporters and importers arising from the complexity of the FTAs and the difficulties trading with Asian markets, including non-tariff barriers. We work with medium sized, often family owned Australian food companies to develop an appropriate market growth strategy (including e-commerce), help them identify and meet the right Asian supply chain and distribution partners, take greatest advantage of reduced customs and excise taxes and help them apply for various government grants and incentives on offer.

Facing up to the real challenges holding Australian agribusiness back from Asian success

The scale of Asian export growth opportunities has been explained and this is offset by the high degree of difficulty in succeeding in these very developing and competitive market places. The export figures presented are solid, but are not growing fast enough to meet Asian consumer demand and compared to our competitors.

An important question therefore arises: *Are we doing enough to take advantage and what more can Australian governments, industry bodies and producers / exporters themselves do?*

When we released *Demystifying Chinese Investment in Australian Agribusiness* report in late 2013, we sought to quantify the actual level of Chinese investment and explain the rapidly growing interest by Chinese investors in our beef, dairy and cotton and branded food product sectors. Our report revealed Chinese investment was actually pretty low, just over AUD 1 billion by December 2012.⁵⁰

Having been away from Australia and agriculture for ten years (working in China), what became obvious when researching for the report was that there are some really major issues (perceived and real) confronting Australia's agribusiness sector which challenges our ability to successfully engage with Asia and China specifically:

- There is a very high level of concern in our society and media about our future food security, foreign land ownership, water usage and an increasing wariness of Chinese investment;

⁴⁸ The Australian, Primrose Riordan, 'Four in five use FTAs: Ciobo', 1 March 2018

⁴⁹ KPMG, 'Access Asia: Leveraging free trade agreements for Australian trade growth', 2016.

⁵⁰ KPMG, 'Demystifying Chinese investment in Australian agribusiness', 2013.

- Australian farmers (especially farmers with smaller family holdings) are rapidly ageing and profit margins are being negatively impacted by selling to major domestic retailers, increasingly high energy and labour costs (and lack of availability). Younger generations of farmers aren't coming through and enrolments in ag-science tertiary courses are not sufficient;
- There is a clear need for further investment in rural / regional infrastructure to enable greater scale, speed and to help drive productivity dividends;
- There is genuine interest from foreign investors while Australian farming companies welcome and continue to receive Asian / Chinese investment as a source of capital for growth or a complete exit. KPMG and Sydney University have continued to update our data on Chinese investment and today based on joint research, Chinese investment in Australian agribusiness increased by approximately AUD 1.37 billion in 2017 which brings total accumulated Chinese investment number to approximately AUD 4.2 billion;⁵¹
- Over the past 100 years, foreign investors with capital and a long term vision from UK, USA, Netherlands, Japan, Brazil and Singapore have invested in most of the large scale Australian agribusiness companies. Australia's food production, processing industry is highly foreign owned through the higher value chain stages.

Over the past few years, we've seen some really interesting developments in Australia which directly impact the agricultural sector. FTAs with key export markets: China, Japan and Korea have been mentioned. There has been a surge in high profile agribusiness conferences, several important new research studies and policy white papers leading to further policy recommendations and key new regulations.

Set out below is a selection of findings and issues identified since 2013:

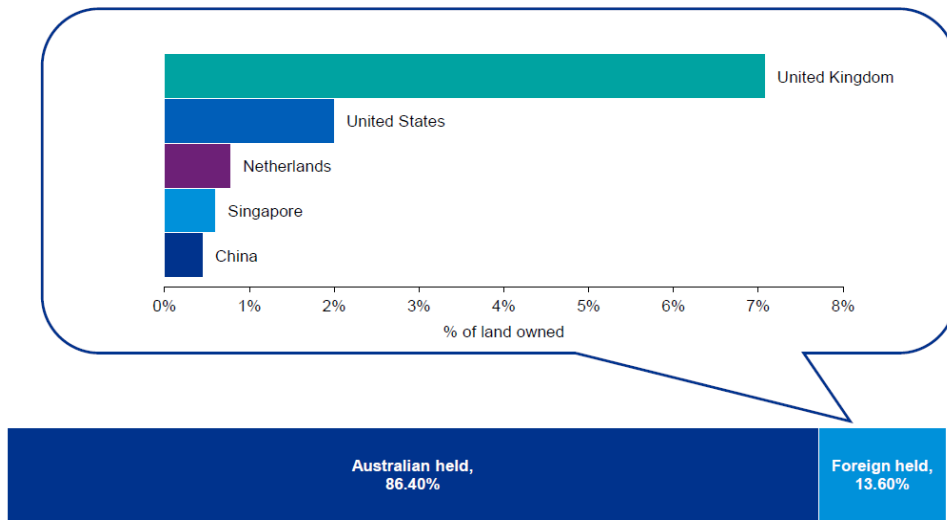
- Public Australian attitudes are becoming even less supportive of foreign investment. The 2016 Lowy Institute Poll found that 87 percent of those surveyed (1,202 respondents) were against foreign investment in agricultural land, an increase of 6 percentage points from the 2012 poll.

Australians are concerned about ownership of Australian agricultural land, domestic food security and future domestic food pricing.

- We now have more facts on foreign ownership. The Federal Government delivered on its commitment to create a foreign ownership register which established that 99 percent of farm businesses are fully Australian owned and 88 percent of farmland is fully Australian owned. In addition, 87 percent of agricultural water entitlements in 2016 were Australian owned. The report also established that about 50 very large foreign companies owned 95 percent of the foreign owned agricultural land – very few were Chinese companies who own about 1 percent of land.

⁵¹ KPMG and University of Sydney Business School database, unpublished.

Foreign investment in Australian Agricultural land⁵²



- Foreign investment regulations have tightened for the agribusiness sector. The Foreign Investment Review Board’s (FIRB) review threshold for agribusiness and land sales was reduced to AUD 55 million and AUD 15 million respectively. The S Kidman & Co. sale process was a major test case which saw Chinese investor applications blocked twice by the Treasurer before being finally approved. This was after the agricultural property adjoining a defence industry site was carved out from the deal, an Australian company formed a bidding JV (with a minority Chinese investor) and gave commitments given to invest further capital to develop scale. This ‘partnership’ model, featuring Australian majority ownership and local Australian management now looks like the investment model favoured by the Federal government for large scale agricultural land and water assets.
- The Agricultural Competitiveness White Paper was released in 2015 and addressed the major problems facing Australian agriculture, including inadequate transport infrastructure and the strong case for urgent investment. From farm gate to destination (including domestic and international destinations) transport costs account for an average of 21 percent of farm gate value. For some farmers (i.e. grain) transport can cost up to 48.5 percent of farm gate value.⁵³ Competition with the minerals sector for rail freight capacity remains a major challenge for meat producers in North Queensland. By 2030, total domestic freight (in tonne-kilometres) is expected to increase by around 70 percent from 2010 levels, with road and rail freight likely to increase by over 80 percent. At a practical level this will mean approximately 300,000 more trucks on the road and greatly increased rail movements.⁵⁴

CSIRO modelling has shown that, if all rural roads were sealed and road trains were able to operate, cost savings in transport could reach 24 percent in the beef industry. It is likely that savings could be achieved across many other food commodities.

The inland rail link and the Western Sydney Airport freight precinct are positive developments and Australia needs a co-ordinated, comprehensive and funded solution for rural, regional infrastructure.

⁵² Australian Taxation Office, 2016.

⁵³ Commonwealth of Australia, ‘Agricultural Competitiveness White Paper’, 2015.

⁵⁴ Ibid.

The inland rail link has been hailed as a critical ‘nation building’ project but was first developed and discussed in the mid-late 1990s. It has taken twenty years and is still being actively debated. For nation building projects of this scale, I believe the Federal Government needs to lead the initial construction financing phase, with private sector participation. As we have seen in NSW and Victoria in the past three years, once built, operating and with measureable proven returns, superannuation funds and other domestic and foreign investors may be ready to participate in the privatisation process.

Back in the mid-1990s, the Inland Marketing Corporation based in the city of Parkes, a key road and rail junction in the food producing heartland of the central west of NSW, developed a visionary plan to airfreight fresh perishable produce overnight to the supermarkets of Asia. The project failed to get necessary government funding and so perishable food still goes on trucks to Sydney and the onto underbelly passenger freight which limits supermarket shelf time in Asia. Projects of this nature and size should now be privately financed, including with foreign / Asian capital and construction expertise. It’s positive to see the Toowoomba airfreight hub privately financed, built and operating and hopefully it proves that the model can work and be replicated across other food production zones around the country.

- The Millennium Drought really hurt our meat and crop industry and highlighted the difficulties that we face in securing our future water supplies – its hurting many parts of Australia again now. Water storages in the Murray–Darling Basin fell below 25 percent of capacity for extended periods between 2007 and 2009 and have been below 40 percent of capacity this year. Without action, it is expected that water capacity per person in Australia (currently 4 mega litres) will fall further to 2.6 mega litres per person by 2061.⁵⁵

Australia needs a co-ordinated, comprehensive and funded water solution. The very recent failure of Federal and State politicians to reach consensus on the Murray Darling plan highlights the complexity of overcoming historical concerns of water usage and diversion of water upstream in the northern states, as well as complex, bitter federal and state political rivalries.

Australia needs a big, bold water blueprint that can be funded either by governments, domestic capital sources or internationally for capturing and moving water from the high rainfall areas of the north and north east to where it’s needed further south to enable not only greater scale but to grow also the water intensive crops that Asian markets desire.

- The White paper on the development of Northern Australia, 2015 showed that reforms to land tenure and improved water and transport infrastructure could open up a quarter of the North’s land area - equivalent to half the size of New South Wales and a 20 percent boost to Australia’s total land under irrigation. The northern Australia project has also been loosely associated with China’s Belt & Road Initiative as a means for potential investment and infrastructure financing.⁵⁶

The Belt & Road initiative (BRI), also called the One Belt, One Road initiative (OBOR) is a signature project of China’s President Xi Jin Ping and is being planned and rolled out for development across the Asia – Central Asia – North Africa and East Europe trade region and throughout South-East Asia, funded by a range of sources including the Chinese Government’s USD 40 billion New Silk Road Fund as well as a considerable share of the Asian Infrastructure Bank’s USD 100 billion balance sheet.

Chinese road and rail construction companies (like John Holland’s parent company CCCI) could help deliver major road, rail, port, water projects in northern Australia but this is a complex situation. The Australian government has adopted a cautious approach to BRI and the recent public controversy over a Chinese company’s long term lease of the Port of Darwin, led to much

⁵⁵ Ibid.

⁵⁶ Commonwealth of Australia, ‘White Paper on developing Northern Australia’, 2015.

stricter national interest reviews of critical infrastructure which may have impacted further Chinese investment for the medium term. Shadow Treasurer, Chris Bowen left open the prospect of BRI oriented projects in the AUD 5 billion Northern Australian Infrastructure Facility in late 2017. Meanwhile, quite recently the USA, Japan, India and Australia have started to talk about their own regional infrastructure plan for Asia which may be interesting to follow.

- The Productivity Commission Inquiry Report into Regulation of Australian Agriculture, released in Nov 2016, established that regulations at every stage of the supply chain were placing a huge and unnecessary burden on farmers. Yet we have not yet seen major reforms to address key issues such as unclear or conflicting regulatory objectives, duplicative regulations or inconsistencies across jurisdictions and rules disproportionate to risk.

In summary there is now a lot more information available and debate going on which is positive. Our political and business leaders now have access to these well researched reports which in most cases make strong recommendations to address key issues that have been holding Australia's agricultural sector back from reaching its full potential to export in scale and more efficiently to Asian markets.

How should Australia take action and adapt to current issues to compete further in the Asian market?

There are many initiatives that compete and need to be prioritised, including:

- Australia needs to develop and push its national brand image into key Asian country markets in a tailored, niche and co-ordinated campaign. Consistent and clear messaging to support the image of Australia's high quality, healthy products needs to be developed to compete with Canada and NZ (et al). It's positive to see that Australia's Red Meat industry have released their 'True Aussie Beef / Lamb and Goat' brand program. Austrade are taking the lead on developing a Nation Brand. This is really important as we saw the success of New Zealand's 'Fonterra' and 'Zespri' International limited brand that accounts for roughly a third of the world's global trade in Kiwi fruit.
- We need our government agencies to assertively raise and address non-tariff barriers at WTO and negotiate effectively with Asian government regulators in key international export markets as this appears to be the biggest issue that food industry leaders are concerned with at present. Both the red meat and dairy industries have undertaken independent studies in 2017 on the opportunity costs of technical non-tariff barriers. For red meat, it was estimated at AUD 3.3 billion and for dairy, AUD 1.57 billion.⁵⁷ Since then, seafood and other sectors have also undertaken similar studies.

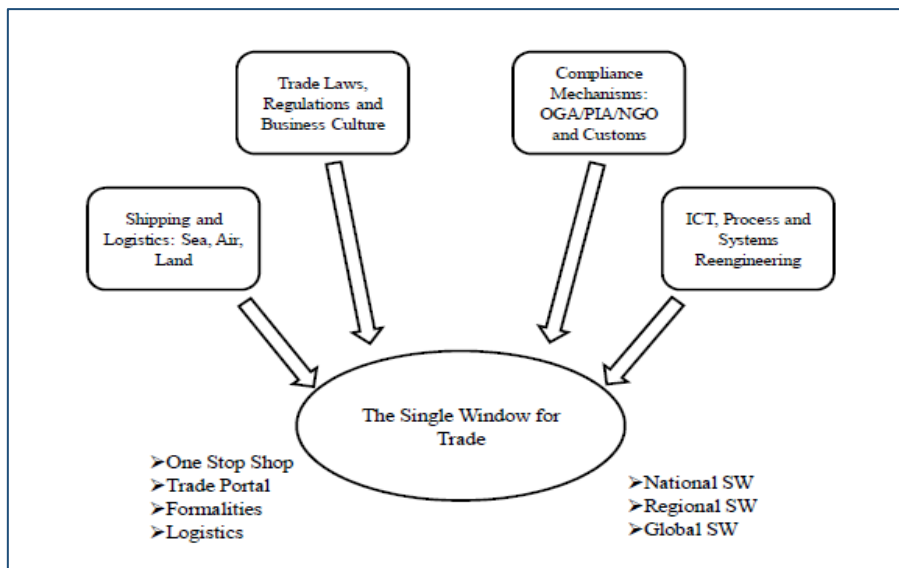
Our SME exporters need continued experienced and practical assistance from the Department of Agriculture, Austrade and state government trade and investment agencies to help solve non-tariff issues in key developing Asian markets, where language and business cultures are the most challenging.

- Domestic infrastructure supply chains should be planned and developed for physical transport, energy and water infrastructure and digital innovation. Roads and rail assets should be bolstered in accordance with the Development of Northern Australia White Paper and utilising Transport Network Strategic Investment Tool (TRANSIT), the CSIRO's tool for identifying opportunities for supply chain optimisation and future infrastructure investments. TRANSIT identifies projects that provide the greatest return to the Australian economy and looks to minimise the cost of such projects whilst maximising long term profitability. TRANSIT maps every possible combination of road and rail transport to optimise vehicle movements.

⁵⁷ DN Harris, 'Comparative evaluation of technical barriers to trade for Australian dairy products', 2017; DN Harris, 'Comparative evaluation of non-tariff barriers for Australian red meat trade', 2017.

- Improvements to Australia’s digital supply chain records should remain a key focus to simplify logistics and maintain the integrity of Australian export food products. Blockchain technology could be used as the technological foundation of a single window trade information platform. The ‘single window’ refers to a single point at which a company can lodge all data required by all government agencies. It is designed to automate and seamlessly approve all electronic lodgements for trade licensing and approvals, and all customs declarations. Through this single window, all logistics can be lodged and scrutinised so that the passage of goods entering and leaving the country may be tracked. The single window is essentially a consolidation of regulatory and general logistical information all entered through the same portal in order to improve efficiency, according to the WTO.

Single window for trade model⁵⁸



- Government departments across all jurisdictions must continue to judiciously focus on increasing productivity and reducing bureaucratic red tape that is negatively impacting rural, regional Australia. Australian farm productivity has grown by 1.5 percent annually (adjusted for climate effect) over the past 10 years but our rate is below the world average of 1.7 percent. Australia does still face significant challenges to productivity.
- The Australian Government and regulators must demonstrate leadership and look to ease concerns about (and prejudice against) Chinese investors and companies in Australian society. Whilst there are some valid concerns about Chinese investment in Australia, the economic benefits should not be underestimated in terms of increased trade to China. In cases where Australia cannot or will not provide the domestic capital needed to support and grow modern large scale farming, foreign capital can help boost production, create jobs and lift the economy.

At the same time, Asian investors need to build greater knowledge and awareness of farming in Australia and build a deep and genuinely trustful social license to operate with local Australian communities, regulators and employees. Beyond capital and offtake, Australian farmers and communities want to work with foreign investors who are experienced (in farming and investing), who can communicate and who understand and respect the natural environment and local communities.

⁵⁸ World Trade Organization, ‘Trade Facilitation and the Single Window’, 2011.

- Where advantageous, Australia should look to integrate with Belt and Road Initiative (BRI) projects in Northern Australia and keep interested and engaged with the ASEAN RCEP opportunity. Apart from the obvious trade benefits, the BRI and RCEP presents further investment opportunities from China and ASEAN into our northern Australian food production zone and infrastructure projects, as well as greater export access to the ASEAN and China markets.
- The government should continue to look to promote agricultural innovation through supporting agtech venture capital industry, encouraging young regional Australians to complete higher technology ag-science education pathways. However, the increasing importance of technology means an increased need for STEM classes in schools and agriculture focused STEM courses at universities.
- There needs to be a fresh look at debt financing for agriculture and perhaps Asian banks or new non-bank disruptors will develop a new debt model that works better for our small and medium scale farmers. There is about AUD 60 billion in outstanding senior debt to the Australian agribusiness borrowing sector and default rates are very low as farmers have been traditionally conservative. This however may be holding back the ambition to build scale quickly through debt funded acquisitions. The traditional and emerging banking sector needs to consider how to develop low interest, long term debt capital markets that are more suitable for the volatile commodities markets and weather cycles (i.e. 2-3 year recovery timeline post drought). We want to see more, younger agribusiness entrepreneurs buying neighbouring farms to build greater scale and investing in the latest high tech machinery and agtech which can be shared or licensed.
- There is also a strong case for tax incentives for capital asset investment, protection for family farming trusts and working immigration visas for seasonal or periodic foreign workers.

Conclusion

Asia remains a massive market opportunity but international competition is rapidly building from traditional and new players, through multilateral trade agreements and disruptions like the Belt & Road Initiative.

Australian fresh premium food is well known and respected by Asian importers and consumers and with a fresh national brand, greater in-market support to resolve non-tariff issues and more effective utilisation of the FTAs by exporters, we can seek to achieve an AUD 100 billion export target, which is more than double what it is in now.

Our proximity to ASEAN and Asian markets is a clear competitive advantage, however we need to quite urgently fix some of our own supply side issues by building greater production scale, building and upgrading rural regional transport and water infrastructure and delivering fresh high quality food faster than our global competition.

We need to also recognise the market power is now in Asian consumer's hands – we need to change our negative attitudes towards Asian foreign investment, work skilfully and respectfully with Asian government regulators on resolving tariff and non-tariff matters and pragmatically build new language and cultural skills and relationships that can sustain the growth we want to achieve in partnership with Asia.



Contact us

Doug Ferguson

Partner in Charge, Asia and International Markets

KPMG Australia

T: +61 2 9335 7140

M: +61 404 315 363

E: dougferguson@kpmg.com.au

Doug was raised in regional North Queensland and his family has an Angus beef cattle business in Bathurst, NSW.

He is a Deals Advisory Partner and leads KPMG's Asia and International Markets business with overall responsibility for servicing approximately 1,000 major Japanese, Chinese, Korean, Indian and ASEAN clients operating in Australia. In this role, Doug travels to China, Indonesia, India, Singapore and other Asian cities approximately eight times per year to meet with clients, both Asian and Australian to advise on M&A deals and trade opportunities.

His ten years living in China and working on major cross border investments and leading the insolvency of Lehman Brothers across North Asia taught him much about the Chinese and broader Asian economy, its consumers and business practices.

Since 2012, Doug has been based in Sydney leading major inbound Asian investment deals across many sectors including agribusiness. In partnership with University of Sydney, KPMG has also been a leading researcher and commentator on Chinese investment, including in the Australian agribusiness sector.

Doug also leads Access Asia – KPMG's trade consulting services business which provides Australian agribusiness exporters with bespoke and practical advice on Asian market entry strategies, supply chain solutions as well as trade related customs tax savings and government grant incentives.

Doug is a Fellow of Chartered Accountants ANZ, Chairman of Asia Society in Australia, a Business Champion and Reference Group member for the Department of Foreign Affairs' New Colombo Plan, an Adjunct Professor at the University of Sydney Business School and China Studies Centre Advisory Council member. He is a former Vice President of the Australia China Business Council in NSW.

KPMG.com.au

This proposal is made by KPMG, an Australian partnership and a member firm of the KPMG network of independent firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity, and is in all respects subject to the negotiation, agreement, and signing of a specific engagement letter or contract and the satisfactory completion of KPMG's internal risk assessment procedures. Should the results of our internal risk assessment not be satisfactory, KPMG reserves the right to withdraw this proposal. KPMG International provides no client services. No member firm has any authority to obligate or bind KPMG International or any other member firm vis-à-vis third parties, nor does KPMG International have any such authority to obligate or bind any member firm.

© 2018 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation.

Document Classification: KPMG Confidential

January 2016