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Overview

# Overview

In this report the Commission assesses whether ‘safeguard’ measures are warranted under World Trade Organization (WTO) rules for Australian producers of processed fruit products. WTO members can take safeguard action when a surge in imports can be demonstrated to have caused, or threatens to cause, serious injury to a domestic industry.

The Commission completed an ‘Accelerated Report’ on 26 September 2013, which assessed the case for imposing provisional safeguard measures, before the inquiry was finalised. It found that the requirements for the imposition of provisional safeguards were not met. Since the release of the Accelerated Report, the Commission has further developed its analysis in light of updated data on imports and exports, submissions received from interested parties, and evidence presented at a public hearing.

## Background to the inquiry

Over the past decade, the Australian processed fruit and vegetable industry has undergone substantial change. Several large manufacturers, including Heinz, Simplot, McCain Foods, National Foods (Berri Juices), Rosella Group and Windsor Farm Foods have consolidated or closed processing facilities.

SPC Ardmona had also signalled at various times that it was facing challenges in maintaining profitability, production and sales levels. Early in 2013, it announced reductions of up to 50 per cent in the intakes of fresh fruit for the following season’s production of processed fruit. The company stated that ‘the current level of profitability is unsustainable for the business’ and that ‘the current and prospective returns to the business do not justify additional capital investments which are required to make the operations competitive’.

In April 2013, SPC Ardmona’s concerns were formally conveyed to the Australian Government in separate written requests for safeguard measures for fruit and tomatoes. Subsequently, the Australian Government directed the Productivity Commission to undertake the two inquiries. The Company has also sought several other assistance measures including a $50 million contribution from the Australian and Victorian Governments to upgrade its facilities, and anti‑dumping measures for the import of processed peach products from South Africa.

At the time of writing of this report, a decision on direct financial assistance has not been announced. The Anti‑Dumping Commission has also not finalised its investigation. However, in its Statement of Essential Facts, the Commission proposed to terminate the investigation following a preliminary finding that the dumping margin for peaches imported from South Africa was ‘negligible’.

### What is a safeguard action?

Safeguard action is temporary emergency action that may be taken by a member country of the WTO where an increase in imports causes or threatens to cause serious injury to a domestic industry. Measures can take the form of an increased tariff, a tariff–quota or quota. Any measures, initially, may only be put in place for a maximum of four years and must be liberalised progressively in order to promote industry adjustment to import competition.

Safeguard measures are invoked relatively infrequently. As at October 2013, there were 31 definitive safeguard measures in place across 12 WTO member countries. All of those countries classify themselves as developing countries.

WTO rules set out several criteria that must be met before safeguard measures can be implemented (box 1).

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| Box 1 When can safeguard measures be applied? |
| Safeguard measures to assist a domestic industry can only be applied if a number of criteria have been satisfied.   1. Imports must have increased in absolute terms or relative to domestic production. The increase in imports must be the result of unexpected and unforeseen developments and be ‘recent enough, sudden enough, sharp enough and significant enough’. 2. The industry must be suffering serious injury, or such injury must be threatened. In assessing injury, factors such as changes in market share, sales, production, productivity, capacity utilisation, profits and losses and employment must be examined. |
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| Box 1 (continued) |
| 1. Increased imports must be shown to have caused, or threaten to cause, serious injury. The impact of other factors must be separately identified and assessed. When factors other than increased imports are causing injury to the domestic industry, such injury shall not be attributed to increased imports.   Safeguard measures may normally be applied for up to four years (including any provisional measures), and possibly up to eight years. Measures can only be applied to the extent necessary to prevent or remedy serious injury caused by increased imports and to facilitate adjustment. |
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### The scope of the inquiry

The Commission has been asked to assess the case for safeguards on imports of several processed fruit categories, including:

* pears
* apricots
* peaches
* mixtures
* citrus fruit
* ‘other’ fruit.

For the like and directly competitive fruit categories that are produced in Australia, SPC Ardmona has a major share of domestic production, and for several products it is the only domestic processor (box 2). Thus, the focus of this inquiry was on SPC Ardmona, as it represents the domestic industry.

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| Box 2 Australia’s processed fruit industry |
| Processed fruit production in Australia is concentrated in the Goulburn Valley region in Victoria, where the production facilities of SPC Ardmona are located. SPC Ardmona is the major producer of processed fruit in Australia, and essentially constitutes the domestic industry for the products under investigation.  SPC Ardmona’s history began with the establishment of two grower cooperatives — The Shepparton Preserving Company, in 1917, and Ardmona, in 1921 — both of which were focused on canning fruit. In 1973, Ardmona commenced tomato processing, and the following year SPC launched its canned baked beans and spaghetti products. |
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| Box 2 (continued) |
| In 2002, SPC and Ardmona merged, forming SPC Ardmona, and in 2005 the processor was purchased by Coca‑Cola Amatil. SPC Ardmona has plants located in Shepparton, Kyabram and Mooroopna, but under a restructuring program that commenced in 2011, processing is being consolidated into an upgraded Shepparton plant.  The growers who supply SPC Ardmona with fresh fruit are also concentrated in the Goulburn Valley area. In its submission to this inquiry, SPC Ardmona noted it had utilised the products of more than 200 growers and suppliers of semi‑processed fruit and vegetable products in recent years. There has been a gradual decline in grower numbers and production volumes over several years, and in April 2013, SPC Ardmona informed around 60 peach and pear growers that it would no longer require their produce. |
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#### Not all of the products under reference are of relevance to the domestic industry

The Commission has concluded that imports of processed citrus and ‘other’ fruit have little potential to affect the domestic industry. The investigation did not identify any domestic producers of processed citrus fruit. The category of ‘other’ fruit comprises a heterogeneous mix of products ranging from apples and plums to berries and exotic fruit. It was found that this category is an insignificant part of the domestic industry’s business and is of little relevance to this inquiry.

Thus, the focus of the inquiry was on the remaining four fruit categories — pears, apricots, peaches and mixtures.

#### Growers are not part of the industry for this safeguards investigation

Much of the public attention and contribution to this inquiry focused on the circumstances of growers affected by the decisions of SPC Ardmona to cut back its purchasing of raw fruit and to reduce the number of contracted growers. The Commission has received many submissions and other information on the significant financial and human consequences to growers of lost or substantially diminished contracts.

The Commission agrees with many inquiry participants that growers have borne a substantial part of the burden of adjustment to date, with reduced volumes, revised quality and variety requirements, loss of contracts and a long period with often minimal real price growth.

However, using the guidance of WTO precedent the Commission determined that the applicant for safeguard measures — SPC Ardmona — and, potentially, other domestic manufacturers of processed fruit, are the relevant industry for the purposes of this inquiry. There is strong WTO precedent against imposing safeguards with the objective of remedying the injury suffered by the *suppliers* to the industry at the centre of the investigation.

Even in the absence of that hurdle, the requested safeguard measures would not help all growers, in particular those who have lost their contracts. SPC Ardmona indicated that it would be able to recover production volumes through larger contract volumes with the growers it has kept for the coming season, and that the capacity of the selected growers to expand production was one of the reasons for selecting them.

## Have imports increased?

Under WTO requirements, safeguard measures can only be imposed if there is clear evidence of an increase in imports of the relevant goods, *either* in absolute terms or relative to domestic production.

There is WTO precedent that the increase in imports also must be ‘recent enough, sudden enough, sharp enough and significant enough’. While a timeframe for the increase in imports is not specified in the Agreement on Safeguards, a rule of thumb that has arisen from the case law is to focus on the last five years for which data are available, and to assess both the trend rate of increase and absolute quantities of imports. The Commission has considered the past five years, but has also looked at earlier data to help it to understand trends in imports of the relevant products.

#### Processed pears and peaches — imports have not increased in absolute terms, but have relative to domestic production

Measured in absolute terms, there has not been a recent, sharp, sudden and significant increase in import volumes of pears and peaches. The import volumes of pears increased marginally over the past five years. The import volumes of peaches increased more sharply between 2009 and 2011, but since then have returned to pre‑2008 levels (figure 1).

Figure 1 Import volumes — Pears and Peaches

Moving annual totals

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| Over the period July 2003 to September 2013, the moving annual total import volumes for pears fluctuated between 0 and approximately 2 kilotonnes. The volume of peaches imported escalated during 2004 and reached a peak in 2005 of over 10 kilotonnes. From 2006 to 2011, import volumes for peaches generally fluctuated between 6 and 8 kilotonnes per annum. In 2011 and 2012, volumes were generally above 8 kilotonnes per annum before declining during 2013. |

To assess whether imports have increased sufficiently relative to domestic production, the Commission calculated the ratio of imports to domestic production for the period 2009 to 2013. The ratio is not a reliable indicator of competition from imports, nor of imports being a source of injury to the domestic industry, because it is sensitive to changes in domestic production levels. Domestic production can fluctuate significantly from year to year and may be influenced by many factors that are unrelated to import competition, for example, weather conditions and export volumes.

In the case of processed pears and peaches, the Commission has found that the ratio of imports to domestic production (presented as an index for data confidentiality reasons) has increased substantially over the investigation period (figure 2). This is sufficient to meet the threshold test of increased imports under the Agreement on Safeguards.

Figure 2 Ratio of imports to production — Pears and Peaches

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| The index of the ratios of imports to domestic production for processed peaches and pears exhibit a similar trend over the period 2009 to 2011. Both indexes increased to about 200 points by 2011. Subsequently, the index value for peaches declined to 150 the following year, before rising to about 165 points in 2013. By contrast, in 2012, the index value for pears reached about 200 index points, before declining to about 175 points in 2013. |

#### Mixtures — imports have increased in absolute and relative terms

The imports of mixtures have increased substantially in the past five years in both absolute and relative terms (figures 3 and 4). This is sufficient to meet the threshold test under the Agreement on Safeguards.

Figure 3 Import volumes — Mixtures

Moving annual totals

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| Moving annual import volumes for mixtures over the period July 2003 to September 2013 show a general upward trend. The moving annual total increased from roughly 1.8 kilotonnes for the 2003-04 year to approximately 7 kilotonnes by 2012-13. |

Figure 4 Ratio of imports to production — Mixtures

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| The index of the ratio of imports to the domestic production of mixtures increased by 150 index points from 2009 to 2011. It declined to approximately 185 index points in 2012, before rising again in 2013. |

#### Apricots — imports have not increased in absolute or relative terms

The import volumes of apricots have decreased over the past five years (figure 5).

Figure 5 Import volumes — Apricots

Moving annual totals

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| Apricots import volumes (in annual total terms) rose during the early 2000s, reaching over 25 kilotonnes in 2005. Import volumes generally declined during 2006 and 2007, falling to around 5 kilotonnes by early 2008 and exhibiting limited fluctuation thereafter. |

The ratio of imports to domestic production has fluctuated but has not increased substantially (figure 6).

Figure 6 Ratio of imports to production — Apricots

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| The index of the ratio of imports to production of apricots increased from 100 index points in 2009 to over150 in 2010, before declining to less than 100 in 2011. In 2012, the value of the index increased to 200 index points, before declining to approximately 125 in 2013. |

The case for a safeguards action for processed apricots is not sustainable on the above trends.

## Is the industry suffering serious injury?

The Commission has concluded, based on its assessment of the available evidence on the indicators set out in the Agreement on Safeguards, that the domestic industry is suffering serious injury.

* Earlier this year, Coca-Cola Amatil announced a $146 million write‑off of SPC Ardmona’s assets.
* Between 2009 and 2012, SPC Ardmona’s domestic sales volumes have declined by between 10 and 32 per cent, depending on the fruit category.
* SPC Ardmona’s profit margins have declined by over 20 percentage points for all fruit categories between 2010 and 2013, and have been negative from 2011.
* Between 2008 and 2013, there has been a substantial decrease in production volumes. Also, for the 2014 season, SPC Ardmona has announced a 50 per cent reduction in the intakes of peaches and pears.
* Employment levels across SPC Ardmona’s production sites have declined substantially between 2008 and 2013.
* The market share of supermarket sales by the domestic industry has decreased slightly, but remained in the order of 70–80 per cent. SPC Ardmona disputed this finding in its submission on the accelerated report, arguing that it was based on data that excluded the sales of ALDI supermarkets. However, further inquiry and analysis by the Commission has confirmed that the inclusion of ALDI would not materially affect the original finding.

## Has injury been caused by a recent surge in imports?

While the domestic processed fruit industry has been suffering serious injury over several years, a key threshold for the imposition of safeguards is whether serious injury was caused by a recent surge in imports. The Agreement on Safeguards states that any injury that was caused by factors other than increased imports must not be attributed to increased imports, nor targeted by the measures.

Increased imports need not be the sole cause of the injury — safeguard measures can be imposed to remedy a portion of the injury that can be attributed to increased imports. However, WTO law requires that there should be at least, a ‘coincidence of trends’ between the injury and any increase in imports.

As discussed above, with the exception of mixtures, no fruit category has exhibited a sharp, recent increase in the absolute *volume* of imports. Overall, the volume of processed fruit imports has not grown substantially in the past five years (figure 7).

Figure 7 Import volumes — Apricots, Pears, Peaches and Mixtures

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| This figure shows import volumes for apricots, pears, peaches, and mixtures combined, from July 2003 to September 2013. Collective imports for these foour fruits peaked in 2004-05, before declining through to the later part of the decade. In the September quarter of 2013, import volumes were approximately the same as what they had been in September 2010. |

Establishing a causal link between changes in the *ratio* of imports to domestic production and injury is more difficult, because, as noted earlier, the ratio is potentially a highly volatile indicator, affected by non‑import, as well as import related factors.

### There has been no *increase* in the price pressure from imports

The key mechanism through which imports could cause injury to the domestic industry is by driving down market prices. This could happen if a decrease in the world price leads to an increase in imports.

SPC Ardmona argued that during the investigation period, the major supermarket chains ‘have moved strongly from 2010 to import products cheapened by the exchange rate appreciation’. However, the Commission’s analysis has not revealed an intensification of competitive price pressure on the domestic producers.

The foreign currency unit values of the imports have *increased* — the opposite of what would have been expected in a safeguards action. The free on board unit values of imported processed fruit, *expressed in Australian dollars*, have remained flat over the period of investigation (figure 8). In the same period, the unit values of SPC Ardmona’s products have fluctuated slightly, falling in 2011 and 2012, but rising more recently.

Figure 8 Unit values — Peaches, Pears and Mixturesa

December 2008 to June 2013

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| This graph shows that the FOB unit values for peaches, pears and mixtures have generally exhibited little variability over the period December 2008 to June 2013. FOB unit values for peaches and pears have tended to fluctuate between 1 and 2 dollars per kilogram. For mixtures, the range has been between 2 and 3 dollars per kilogram.   The unit values for SPCA peaches, pears and mixtures are higher than the FOB unit values, generally lying between $4.50 and $5.50 per kilogram for peaches and pears and between $5.75 and $6.50 for mixtures. |

In its submission on the accelerated report, SPC Ardmona disputed the Commission’s approach of analysing unit values at the aggregate tariff subheading level, arguing that it masked significant variability (and injury) at individual product levels. To support its claim that some of its branded products were coming under increased price pressure from imported products, SPC Ardmona provided confidential sales data for several product lines.

However, the approach advocated by SPC Ardmona would not meet either the terms of reference as determined by the Government or the requirements of the WTO. The Commission is required under the notice in the Commonwealth of Australia Gazette and its terms of reference to examine the tariff subheadings in their entirety. Furthermore, import data at individual product level are not available from the Australian Bureau of Statistics (ABS). The ABS data are the only source of objective information on import volumes and values at the tariff subheading level.

The Commission did, nevertheless, review the retail level data provided by SPC Ardmona. Of the nine product lines for which SPC Ardmona provided data, five demonstrated *stable* or *increasing* prices, with the remaining four showing only a moderate decrease. This did not provide a basis to conclude that an increase in price pressure from imported products was causing injury to the domestic industry.

This is not to deny that international trade *per se* can affect the prices achievable by the domestic industry. The ready availability of imported products constrains the ability of domestic producers to raise their prices, without losing market share to their international competitors.

However, in the context of relatively stable import unit values, any *changes* in the markets for SPC Ardmona’s branded and private label lines relate to other factors.

### Other factors have caused the injury

Several factors have contributed to the injury suffered by the domestic industry.

#### Decreasing domestic demand for processed fruit

The domestic demand for processed fruit, irrespective of the country of manufacture, has been decreasing for several decades — a trend that Australia shares with other developed countries. Over the past five years, retail sales of processed fruit have declined by more than 20 per cent (figure 9).

Figure 9 Supermarket sales — Peaches, Pears and Mixtures

Moving annual total

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| This figure illustrates total supermarket sales of processed pears, peaches and mixtures from December 2008 to June 2013. On an annual basis, total sales were about 43 kilotonnes in December 2008, but had declined to 32.5 kilotonnes by June 2008. |

Changing consumer preferences toward more convenient processed food alternatives, as well as greater availability and reduced relative prices of fresh fruit have driven this shift in consumption. Supermarket advice, previous presentations by the processing industry and available data on fresh fruit consumption support this conclusion.

#### Reduced export volumes

Some of the injury to the domestic industry was driven by decreases in the volume of exports of processed fruit — a consequence, at least in part, of the appreciation of the Australian dollar. Exports used to account for a substantial proportion of domestic production — for example in 2009, most of the domestic production of pears was exported.

Between 2009 and 2012, the combined exports of processed peaches, pears, apricots and mixtures have decreased by 57 per cent. These recent years have continued a longer‑term trend — since 2003, Australian exports of processed fruit have decreased by 87 per cent.

#### Rising costs of production

SPC Ardmona’s profit margins have been affected by rising costs of production. While sales revenues per unit remained stable between 2010 and 2013, SPC Ardmona reported that its production costs increased by around 19 per cent on average.

In large part, those cost increases on a per unit basis appear to be attributable to the loss of economies of scale — a consequence of the contraction of export volumes and the decline in the domestic demand for processed fruit.

#### Supermarket private label strategies — a feature of domestic competition

The past five years have seen considerable growth in the market share of processed fruit products sold under the supermarkets’ private label brands. The emergence of the private label is not a new market development. Such products have been sold since the 1960s, with supermarkets in the past typically marketing them as a lower cost and quality alternative to branded products.

However, in the period under review, the private label strategies have evolved. Supermarkets have begun to offer ‘tiers’ of private label products, with the premium tier emerging as a direct competitor to the branded product range. This has reduced the capacity of producers of branded products to charge premium prices without losing market share.

The growth in private label sales is not of itself an indication of a surge in imported products — many product lines can be sourced locally. However, imports, or the threat of them, can be used as a negotiating tool for new supply arrangements, for example, to achieve a lower price.

SPC Ardmona has remained a significant (and for two fruit categories, major) supplier of private label products to supermarkets over the past four years. Furthermore, since the investigation commenced, several supermarket chains, including Coles, Woolworths and ALDI, have announced a shift to greater domestic sourcing of their private label processed fruit products.

There are many commercial reasons for supermarkets to promote their private label brands, and several factors were at play in the market for processed fruit in the period under investigation. In particular, the change in Coles’ strategic direction under (relatively) new ownership and the entry of ALDI (which has strong experience in private label products), has intensified competition within the Australian retail market and led to greater preference for private label brands by the major supermarket chains.

SPC Ardmona’s dominant position in the domestic market for processed fruit may also have encouraged supermarket chains to use private labels to enhance competition in this market.

#### Imports being used to improve reliability of supply

In Australia, the growing of fruit for processing is geographically concentrated and susceptible to adverse weather events. In the past, supermarkets have shifted to international suppliers to ensure a reliable supply of products, for example, following severe frost in the Goulburn Valley that destroyed most of the 2004 harvest. SPC Ardmona was also at various times an importer of processed fruit products. In this context, an increase in imports is not a cause of the injury to the domestic industry, but a response to factors affecting the domestic industry.

## Have the criteria for safeguards been met?

In this report, the Commission has concluded that of the four product categories of relevance, only one (mixtures) demonstrated a sufficient increase in imports in both absolute and relative terms. Two other product categories (pears and peaches) have, nevertheless, demonstrated an increase in imports *relative* to domestic production — also sufficient to pass the threshold test of increased imports under the Agreement on Safeguards.

The domestic processed fruit industry is suffering serious injury. However, injury was not caused by an increase in imports of products under reference.

The clearest indicator of a surge in imports causing injury to the domestic industry is increasing price pressure from imported products. There was no compelling evidence of this for any of the product categories.

Other factors have caused the injury, including: decreasing domestic demand for processed fruit; rising domestic costs of production; and decreasing export volumes. Also playing an important role were domestic competitive pressures in the retail sector, where the availability to the supermarket chain of the option to import provides the threat of reduced margins for SPC Ardmona, but where the choice of that strategy is, ultimately, a domestic decision.

The Commission has determined that for the products under reference, definitive safeguard measures are not warranted.