SUBMISSION BY AUSTRALIAN MEAT INDUSTRY COUNCIL

TO

PRODUCTIVITY COMMISSION SAFEGUARDS INQUIRY INTO THE IMPORT OF PIGMEAT

NOVEMBER 2007

INTRODUCTION

The Productivity Commission (PC) will conduct a safeguards inquiry into the import of pig meat into Australia.

As in 2005, the Government has stated that it understood the pork industry's concerns about the current economic difficulties being experienced by producers as a result of a combination of factors, including the drought, increasing import volumes, a higher Australian dollar and lower domestic prices. The Government is concerned about the current economic situation facing the industry - particularly as it relates to regional employment and the need to ensure a sustainable and vibrant Australian pork industry.

The inquiry will look into whether or not safeguard action is justified taking into account the requirements of GATT Article XIX on emergency action against imports and WTO panel and appellate body decisions interpreting safeguard provisions.

This submission to the Productivity Commission is on behalf of the independent retail butchers and the smallgoods manufacturers who are members of the Australian Meat Industry Council.

THE AUSTRALIAN MEAT INDUSTRY COUNCIL

The Australian Meat Industry Council (AMIC) represents companies and employers in the post farm gate meat industry. These include abattoirs, boning rooms, smallgoods manufacturers and retail butchers. AMIC has approximately 2,500 members in all states and territories of Australia.

AMIC represents three groups of members who depend on the Australian pig meat industry in their business:

- Independent Retail Butchers who rely on the supply of fresh Australian pork for 31% of their sales and sell approximately 27% of the fresh pork meat retailed in Australia.
- Small to medium smallgoods manufacturers who are unable to access imported pig meat for their products.
- Large smallgoods manufacturers who import pig meat but rely on Australian pork for much of their production, particularly bone-in product and uncooked smallgoods products.

AMIC members therefore, have a great concern for the future of the pig producers of Australia.

The smallgoods sector has a member-elected National Smallgoods Council which meets quarterly to decide on policy and direction on industry issues.

Because the smallgoods sector is represented by a relatively small number of companies AMIC is in a unique position to seek the opinions of the decision makers in important industry issues and represent those members while protecting the commercial interests of the individual companies.

The Independent Retail sector is represented through member elected State Councils which in turn elect a National Retail Council which also meet quarterly.

Consultations within the smallgoods and retail sectors by AMIC have resulted in a variety of views on the competitiveness issues facing the Australian pigmeat industry. Owing to the diversity of the sectors and the views produced, it would be unreasonable to expect a single view to emerge of what should be done to address the issues facing the industry. Nevertheless a number of relevant issues have been identified through these discussions, which AMIC believes are of value to the Commission's Inquiry.

CURRENT SITUATION FACING THE PIG MEAT INDUSTRY

The Australian pig meat industry is facing serious challenges. In recent years, apart from normal cyclical ups and downs, it has had to cope with an ongoing drought. It has been subject to low returns, increased competition from imports, and a stalling in export market growth.

It is apparent that the underlying situation facing the industry is not improving and some of the strategies employed since 2005 are not effective. Imports appear to be growing, exacerbated by the strategy to direct Australian pork to fresh meat sales with no increase in Australian production. Exports have not provided the solution to the industry's problems and, coupled with the drought-induced high feed prices, profitability for much of the industry continues to be under pressure.

The smallgoods sector and independent butchers are the majority users of Australian produced pork. The opportunity to expand the use of Australian pork therefore rests with these users. Both sectors remain critical of the lack of market development funding directed to expand their markets. Some industry strategies have proven to be counterproductive due to lack of adequate consultation with the smallgoods sector and fresh meat retailers.

As a result of the concerns of the impact of import competition there have been reviews by the productivity Commission in 2005, a safeguards inquiry by the Commission in 1998, an industry Commission review in 1995 and an anti dumping and countervailing duty investigation by the Australian Customs Services in 1992.

The following is the Australian Meat Industry Council submission on the questions asked by the Productivity Commission in relation to the pig meat industry.

Question 1: Have imports increased?

The period 2001 to 2006 has seen a steady increase in the tones of pig meat imported into Australia. From a low of 43,297 tonnes in 2001 the high was 80,215 tonnes in 2005 with a reduction to 71,222 tonnes in 2006. The average is 59,934 tonnes.

The year to June 2007 saw imports reach 105,491 tonnes which is a 45,557 tonnes increase on the average.

However, the sales of fresh pork within Australia have also increased from 163,312 tonnes in 2003 to 198,504 tonnes in 2006. The average is 185,600 tonnes.

The year to June 2007 also saw sales of fresh pork reach 228,314 tonnes which is a 42,714 tonnes increase on the average.

During the same period of time the total pig meat production in Australia has been relatively constant as has the production of processed product (smallgoods).

It is reasonable to conclude that the successful industry strategy to increase fresh pig meat sales in Australia is a major contributor to the increased imports of pig meat.

It should be noted that:

- Not all Australian pig meat is more expensive than imported product.
- Australian domestic production cannot meet the demand for fresh pork and smallgoods production. There is a shortfall of more than 38,000 pigs per week.
- The smallgoods industry in Australia is by no means indifferent as to the fate of Australian pig meat production and processing. Indeed smallgoods manufacturers have supported the industry by paying above-import prices on occasions, but cannot do this on a sustained basis if they are to remain viable. Smallgoods manufacturers have a vested interest in maintaining a viable pig production and processing industry in Australia because imports cannot be used in products which are not heat treated to AQIS protocols.

- Pricing of pig meat products. Volatility in pig meat prices both within Australia and on imported product adds to uncertainty in the industry. This volatility is used by some retail and food service customers to ensure that purchase price is reduced on a falling pig market. This ensures that pig producers and smallgoods manufacturers are forever in a profit squeeze.
- More broadly, there is concern that the pricing of pig meat has not been optimized – that it is perceived by consumers as a cheap meat, and opportunities for obtaining premiums are not being realised. This also ensure the producer and manufacturer profit squeeze is maintained.

Productivity Commission March 2005 Finding 4.3

Imports of pig meat into Australia do not benefit significantly from foreign subsidies. Government assistance provided to pig meat producers in Denmark and the United States is low. Somewhat more assistance (but still low) is provided to pig meat producers in Canada.

In relation to the immediate future import trends of pig meat into Australia the picture is not clear.

The Australian dollar has moved significantly up in recent times and there are predictions that it will return to more “normal” levels in early 2008.

Denmark, Canada and the United States are reported to have similar cost pressure on pig production due to the high costs of feed resulting in low profits. The introduction of ethanol into petrol stocks is encouraging USA farmers to move from wheat to corn thereby increasing the costs of available feed stock. The reports say that sows are increasingly seen in the abattoirs indicating that there producers are reducing numbers as they also go through a rationalization similar to Australia. (“Whole Hog Brief” newsletter 1 October 2007). It is therefore probable that the cost of imported pig meat will rise in real terms and the volume will reduce.

Given that there is no incentive for Australian pig producers to increase production it is probable that imports of pig meat will continue albeit at reduced levels in the immediate future.

It should be noted that smallgoods processors generally derive little profit benefit from the import of pig meat as any reduced cost which may accrue is passed on to retailers and ultimately consumers. The ever changing retail price of ham and bacon products, and the level of discounts provided on promotions, is evidence of the level of the consumer benefit.

Processors who do not import pig meat when the cost of those imports is lower than Australian pig meat, or are not large enough to comply with the strict protocol which applies, can be at a disadvantage if wholesale prices to retailers generally reduce due to that lower input price.

Australian Quarantine Inspection Services (AQIS) protocols require all imported pig meat to be under their control until it is heat processed (cooked) through the manufacture of smallgoods. As a result there is no imported pig meat sold as fresh meat in the retail sector in Australia

Question 2: Was the increase in imports the result of unforeseen developments and the result of (WTO) obligations incurred?

The importation of pig meat into Australia is a function of market forces which have resulted in a net shortage of pig meat in Australia. Industry strategies have focused the available production towards export of Australian pigs and the fresh meat market within Australia.

The situation in which the Australian pig producers are currently placed is one of extremely high costs of production due to the high costs of feed grains.

Productivity Commission March 2005 Finding 4.1

The competitiveness of Australian pig producers in the domestic market and some international markets declined between mid-2002 and the end of 2003, largely reflecting movements in exogenous factors such as exchange rates and feed prices. There are mixed signals on recovery. Both exchange rates and feed prices moved favorably during 2004, enabling some recovery of profitability, but imports continued to grow while exports declined. Such fluctuations in competitiveness are likely to continue.

Productivity Commission March 2005 Finding 5.1

Continuing improvements in practices internal to a pig meat business are important to maintain long run competitiveness with foreign competitors. In the short run, however, these internal factors are unlikely to offset such influences as large unexpected movements in feed grain prices and exchange rates.

Productivity Commission March 2005 Finding 8.1

The Australian pig meat industry and pig meat businesses can pursue a range of measures to improve business competitiveness. The relative merits of any such measures are best judged by individual pig producers or processors, or by the industry as a whole.

Question 3: Defining the industry: Who are producers of "like" or "directly competitive" goods?

The market segmentation for pig meat is an important distinction to be considered by the Productivity Commission:

- Fresh pig meat sold through retail outlets in Australia is sourced from lower weight, younger pigs.
- Bone in pig meat product must be sourced from Australian pigs and cannot be imported under AQIS protocols.
- Imported product must be heat treated under AQIS protocols and it therefore only available for further processing (smallgoods).

The Commission's 1998 safeguard inquiry determined that pig producers output (pigs) was "like" and "directly competitive" with imports of frozen, boned pig meat.

Much of the imported pig meat is partly processed, trimmed, primal meat ready for further processing. There is no requirement to pass this product through a boning room before further processing. There is a body of opinion that the genetic structure of imported pig meat is more consistent and more suitable for Australian markets.

It could therefore be argued that the imported pig meat primals are not the same product that is being marketed by the Australian pig grower although at some time in the process both products become competitors for boneless further processed smallgoods.

The products sold in Australia as fresh pig meat and bone in products are not direct competitors of the imported boneless product for further processing by heat treatment.

The very successful industry strategy towards increased sales of fresh pig meat in Australia is through a pig product which is significantly different from imported pig meat even if the AQIS protocols did not require heat treatment.

It could be reasonably concluded that there is a degree of product differentiation between imported pig meats and the Australian pig meat.

Question 4: Has the industry suffered, or is it likely to suffer, serious injury?

"Serious injury" is defined by the WTO as a "significant overall impairment in the position of the domestic industry".

"Threat of serious injury" means "serious injury that is clearly imminent".

The number of pig producers in Australia continues to decline. Production of pig meat, however, is relatively constant. The remaining producers have greater output and benefit from economies of scale, with an increasing concentration of production.

The producers of Australian pig meat are suffering great financial pressure. The cost of production has been calculated at $3.00 per kilogram based on feed grain costs of $400 per tonne. The ongoing drought, the introduction of mandatory levels of ethanol in fuel and the resulting cost of grain has the pig production industry in severe losses.

Australian Pork Limited has estimated that the industry is currently losing \$3m – \$4m per week based on the production cost of \$3.00 per kilogram and a sales price of \$2.20 per kg (APL press release 12 September 2007).

There is evidence that most purchasers are currently paying considerably in excess of the \$2.20 per kg quoted above, particularly for pigs for the fresh meat market. As at the date of this submission the quoted price for “bacon pigs” (for the smallgoods market) is \$2.49 per kg and for “pork pigs” (for the fresh meat market) is \$2.81 (The Land 22 November 2007).

When considering the returns to pig growers the APL strategy of promoting fresh pig meat sales through major retail channels at promotional prices is questionable.

With the pig production industry currently sustaining considerable losses there is no incentive to add to capacity through investment which leaves importing of pig meat as the only alternative to meet the current demand in Australia.

Question 5: Are imports causing serious injury?

It is difficult to differentiate between import damage and the effect of cost of production and exchange rate on exports and imports. Although the number of pig producers continues to contract from some 5,800 12 years ago to around 2,000 today, the total domestic production has remained relatively constant in the last five years.

Sales of domestic fresh pork have risen 39.8% between 2002 – 2003 and 2006 – 2007 as a result of promotional programs by Australian Pork Limited through the retail sector. The smallgoods processors sector volume has increased by only 1.1% during the same period.

The obvious conclusion to this is that the large smallgoods companies have imported pig meat to make up the shortfall from domestic production, understood to be more than 38,000 pig equivalents per week.

It is therefore concluded that the imports, being a part of the matrix, are not the sole cause of the financial difficulty being experienced by the Australian pork industry.

Question 6: What safeguard measures would remedy serious injury?

The Productivity Commission in 1998 made the observation “that it is far from clear that such actions (safeguard measures) would be the most appropriate way of assisting the pig meat industry. Trade restrictions would be a blunt and indirect way of providing assistance – with all pig producers and primary processors assisted regardless of need – and would reduce incentives for pig meat businesses to adjust. Such restrictions are more likely to discourage change and restructuring. Restricting imports of pig meat would also adversely affect pig meat consumers, retailers and manufacturers. It might also detract from Australia’s capacity to seek reductions in overseas trade barriers.” Productivity Commission 18 March 2005 p XXXII.

Productivity Commission March 2005 Finding 8.4

While additional restrictions on pig meat imports into Australia may provide short term benefits to pig producers, they would adversely affect Australian pig meat consumers, retailers and manufacturers. They could also discourage or delay ongoing restructuring and would fail to target those in greatest need of assistance.

The 1999 PC Inquiry report considered that if the cost of a major input – pig meat – rises owing to the imposition of safeguards on imports, the cost of supplying ham and smallgoods would also rise. A higher price would reduce consumption, leading to a contraction of the smallgoods sector. Consumers would also be worse off, paying higher prices and consuming less smallgoods.

The PC felt that if imports of smallgoods were to expand, the smallgoods sector could suffer a double whammy, being hit by higher costs for pork and more competition from imports of smallgoods.

The introduction of a levy on imported pig meat would have a disastrous effect on the processing industry as it would not be recovered in higher prices to retail and food service customers.

The introduction of a restriction on imported pig meat would have the short term effect of a sharp rise in the price of Australian pig meat but this would again be reflected in reduced margins, or losses, to smallgoods manufacturers. Fresh pork to independent retailers and supermarkets would also become too expensive as consumers have firm opinions on the value of fresh pork. Instead of assisting the Australian producers the effect in the medium term would be to reduce demand and put the future of Australian pig growers in greater doubt.

Some pig producers believe that the imposition of safeguards would detract from the long term rationalization of the industry and, when eventually removed, place producers in an even worse position than they are now.

The conclusion is that the introduction of safeguards would not resolve the current financial position of the pig producers of Australia and may in fact be counter productive.

Question 7: What are the impacts on other parties?

The imposition of safeguard action would have a wide and serious effect on various parties.

The impact on smallgoods producers is complex and affects the type of products imported and the processing requirements in the individual business. In times of severe labour shortages some smallgoods manufacturers have taken advantage of imported pig meat which does not require further preparation prior to smallgood manufacturing. Imports have become a key component of Australian smallgoods sector production.

A limitation on the volume of imported product would mean that smallgoods processors would not meet their supply obligations to customers and long term damage would result in confidence of supply and there would be financial damage through loss of profits and penalties to the particular company.

Frequently food service companies rely on the supply of product from one manufacturer. Failure to supply resulting in products not being available on a menu, can lead to long term loss of business.

Major retailers look to the return available from their refrigerated cabinet. A shortage of supply will mean that a replacement product, not related to the pig industry, will appear, frequently resulting in a permanent loss of that space.

Some customers include penalty clauses in supply contracts which can lead to loss of profit claims for non supply.

Some Australian pig producers see the restriction of imported product as a "quick fix" to their profitability problems as there would be a sharp increase in the price of Australian pigs in the short term. The effect of this increase in price would not be sustainable as the fresh pig meat industry would be priced out of the market, the smallgoods manufacturing industry would sustain even greater losses and the reduction in demand and competition may result in an even worse position for Australian pig producers.

There would also be a greater incentive for finished smallgods products to be imported into Australia to the detriment of the whole industry. It is currently possible to imported cooked ham products from Canada, Denmark, Sweden and Finland. A levy on imported fresh pig meat would create a cost differential which would encourage cooked product to enter Australia from countries which are also suffering high costs of pig production.

The overall shortage of 38,000 pigs per week in Australia does not support any serious consideration of a limitation of imported pig meat.

A levy on imported pig meat would not be passed on to customers in the short term and current losses by smallgoods manufacturers would be exacerbated.

In the longer term the levy may be passed on, depending on competitive forces, which would then be paid by the consumers of the final product.

The imposition of a levy or restrictions on volume of pig meat into Australia could result in retaliatory actions from importers of Australian red meat and other products. Australia is a part of the global trading economy. During a previous period where the importation of pig meat was the subject of a legal challenge the United States of America was particularly vocal on this subject. The export of red meat is a major contributor to the Australian economy and any retaliation would have serious effects.

Owing to the important role played by imports in the smallgoods sector, in the event that imports are restricted or a levy applied to assist the continued viability of the pig production and processing sectors, assistance will need to be provided to the smallgoods manufacturing sector to ensure it is not adversely affected.

INDUSTRY STRUCTURE AND FEED COSTS

APL has estimated that in a carcase cost of production of $3.00 per kg the feed cost component is $2.00 (66%).

If the feed cost was $200 per tonne instead of $400 per tonne the total cost of production would be reduced to around $2.20 per kg.

Feed grain is by far the major cost factor in pig production. There appears to be a wide-spread view that Australian producers are still not obtaining feed grains at export-parity prices. This needs to be fully and independently investigated in order to improve the competitiveness of the pig meat industry as a whole.
The redirection of food grade grain to ethanol production, now supported in some States by legislation, at a time of serious drought requires immediate intervention by Government. This strategy has effectively added to the problems faced by pig producers in the last two years.

Productivity Commission March 2005 Finding 7.2

Single-desk marketing arrangements for domestic and export sales of Australian grain have the potential to raise domestic prices for grain, particularly during drought, reducing the competitiveness of all domestic grain-using industries (including the pig meat industry).

Productivity Commission March 2005 Finding 7.3

Government support to encourage the expansion of the ethanol industry is likely to raise domestic prices for feed grain, adversely affecting the pig meat and other intensive livestock industries. The impact will depend on the extent to which feed grain is used for ethanol production, and the size of the ethanol industry.

The Annual Report of the Pork Cooperative Research Centre (CRC) states that progress has been made in feed conversion in Australian pigs. The Chief Executive Officer reports that a project undertaken by the CRC has resulted in an annual feed cost saving of $2.08m for one of the industry's biggest end users. (CRC Media Release 21 November 2007).

It can be concluded that, while there is significant progress being made in the conversion of feed in Australia piggeries the overall cost of feed is currently causing the costs of pig production to be well in excess of the value of those pigs in the Australian market.

CONCLUSIONS AND RECOMMENDATIONS

1. While the imports of pig meat have increased, so too have the sales within Australia of fresh pork products, with no increase in total production. The APL strategy on the promotional pricing of fresh pork through major retail chains should be reconsidered.

2. The increase in the imports of pig meat are a function of market. forces and, to a degree, current industry strategies. They are not unforeseen or a result of WTO obligations.

3. The imported pork products are not the same product sold as fresh pork or bone-in product in Australia and are destined for further processing because of AQIS protocols.

4. The financial suffering of the Australian pork producers is due to cost pressures, mainly related to feed grain prices and the ongoing drought, and not caused directly by the imports of pig meat.

5. The application of safeguards measured either by a restriction on quantity or a levy on imported pig meat, would have a number of unacceptable adverse consequences and no long term gain to Australian pig producers. There could even be a negative outcome to the detriment of those growers.

6. The issues relating to the high cost of grain for feed must be addressed. Despite the improvement in conversion costs of feed in Australian pigs, this item is the single largest issue facing the Australian pig industry.

7. The long term security for the Australian pig producers is best served by a whole of industry strategic plan, developed under Government supervision, which properly addresses each of the factors which affect the future of the greater pork industry.

The Australian Meat Industry Council
23 November 2007