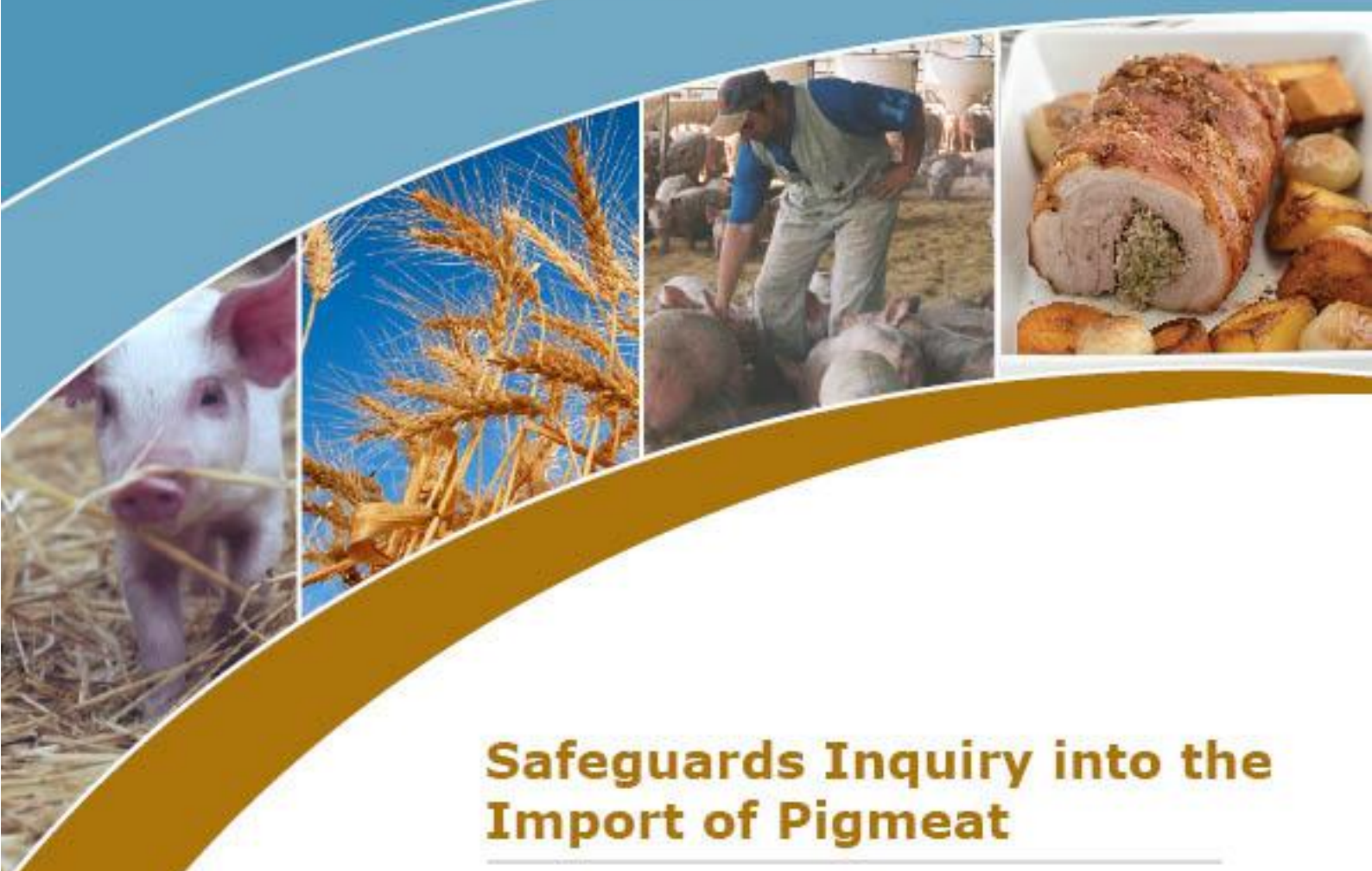
# AUSTRALIAN PORK LIMITED

## Australian Government Productivity Commission

## Submission #1

## 23 November 2007



# Safeguards Inquiry into the Import of Pigmeat

# 2007

Australian Pork

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**Annexes (see attached)**

# Acronyms

| | |
|---|---|
| **AB** | **Appellate Body** |
| **ABS** | **Australian Bureau of Statistics** |
| **APL** | **Australian Pork Limited** |
| **AUSFTA** | **Australia – United States Free Trade Agreement** |
| **EC** | **European Commission** |
| **CWE** | **Carcass Weight Equivalent** |
| **GATT** | **General Agreement on Tariffs and Trade** |
| **HSCW** | **Hot Standard Carcass Weight** |
| **ITS** | **ITS Global \| Consultants on Global Issues** |
| **LHS** | **Left Hand Side** |
| **MAT** | **Moving Annual Total** |
| **PC** | **Productivity Commission** |
| **RHS** | **Right Hand Side** |
| **SW** | **Shipped Weight** |
| **UNE** | **University of New England** |
| **US** | **United States** |
| **WRI** | **Western Research Institute** |
| **WTO** | **World Trade Organisation** |

## Introductory comment

The terms of questions addressed in this submission, which reflect questions posed by the PC in its Issues Paper with regard to provisional and general safeguards, do not require the testing of the conditions which merit the imposition of Provisional Safeguards. This is important for adequately addressing the terms of the Agreement on Safeguards ("Safeguards Agreement").

Accordingly, an additional Question 5a - "Are there critical circumstances where delay would cause damage which it would be difficult to repair?" - is posed and answered.

For the purpose of this analysis, APL is restricting its comments to border measures. So serious is the injury facing the industry that unless immediately addressed the consequent damage would be severe and lasting. Only a provisional safeguard will provide the necessary immediate breathing space required by the industry to arrest further damage to it. Other complimentary measures at this critical point would be redundant in their effectiveness if undertaken in isolation without a provisional safeguard. APL will provide further detail on other proposed non-border measures in it subsequent submission.

As advised to the Commission on 26 October 2007, APL will also address the remaining terms of reference for this inquiry concerning the recent changes in the structure and operating methods of the industry and whether any immediate actions could be taken to complement the activities of the Pork CRC in order to alleviate the impact of high prices and restricted availability for feed grains in a subsequent submission.

## Executive Summary

Australian Pork Limited (APL) is providing this submission to the Productivity Commission's (PC) Inquiry into whether safeguard measures under the WTO should be imposed on imports of frozen pigmeat. This submission is focused on providing the information required for the Commission's accelerated report on whether provisional safeguard measures should be imposed. A further submission will be provided for the report on full safeguards.

This inquiry will be a watershed for the wider Australian pork production industry. It has the potential to change its direction forevermore either enabling it to repair, rebuild and restructure by providing immediate relief from the continued and substantial injury resulting from imports and that has been so pervasive or accelerate its decline, by rendering a large part of the industry unviable and leading to its inevitable collapse.

**The pork industry is facing a crisis.**

Producers and primary processors (abattoirs and boning rooms) are facing mounting losses. Many producers are losing an estimated $40 per pig which if applied across the whole industry on an annualized basis would be $182 million.

The losses are also accelerating – up from $30 per pig only a few months ago. Any delay in measures to address the losses will mean more producers and primary processors exiting the industry.

**The industry is facing a collapse of its critical mass.**

The magnitude and direction of losses will cause producers to exit and the breeding herd, on which the industry relies for its future production, to be cut. This is confirmed by surveys of producers. The damage is occurring to such an extent that it will be severe and lasting. Processors are similarly being forced to reduce output and cut employment. The industry's facilities have limited or no alternative uses.

Pig raising decisions made in the industry take up to a year to flow through to production. With the critical mass of production undermined, processing capacity will be forced to

close. The consequence of delay in measures to address the situation will be potentially catastrophic for the industry.

At considerable risk are the substantial gains that have been made by the industry to improve its competitiveness and productivity, the phenomenal increases achieved in fresh pork per capita consumption and indeed the ongoing investments in these areas to improve our efficiency and as embodied for example in the establishment and work of the Pork CRC. Since 2004 the industry has worked to reshape itself, driving change where we have competitive advantages and strategically repositioning itself.

Based on current trends, with production forecast to decline and as producers continue their exit from the industry or reduction in their breeding herd, it is anticipated that the current supply to the market will fall below existing levels, increasing fresh pork prices. This would not only push some consumers out of domestic pork consumption, but would also damage pork's current brand value position, causing long term damage to pork volume.

**Imports have caused the damage.**

Imports have risen inexorably since the trade was liberalised in accordance with the WTO Uruguay Round. Several "unforeseen developments" occurring after the negotiation of the tariff concession in 1994 (the binding at zero) that were not "expected" at the time it was negotiated together have resulted in increases in imports. Unexpected factors, such as the price gap between imported and domestic products (brought about by persistent drought and rising production costs) in combination with quarantine factors, have all resulted in increases in imports.

Imports have risen from negligible levels when the market was opened to over 160,000 tonnes (carcase weight) currently. There has clearly been a meteoric increase of imported pig meat: the August 2007 annual forecast being over 126 percent of the 2002. It is also clear that the rate of growth has sharply accelerated during 2007 with the year to August 2007 import rate extrapolating to a 40 percent growth over 2006.

The damage caused to the industry by imports is confirmed by economic modelling provided with this submission. It is manifested through a price ceiling imposed on pig prices in Australia due to the prices and volumes of frozen pig meat imports. The

modelling clearly shows the strong correlation between increasing import volumes and decreasing domestic pig prices.

**The threat of imports is accelerating.**

Imports now account for most of the market for the products used for further processing. The relative rise in the share of imports is marked in the most recent year, when the share of imports of apparent consumption rose from around 26 percent to 34 percent – an increase of 8 percentage points over just one year. This contrasts with the 8 percentage point rise in import penetration over the previous 3 years. Clearly there has been a marked acceleration in the pace of import penetration.

As the penetration of imports increases, it threatens to capture the whole processed market in between one and two years Imports threaten to make the Australian industry almost totally reliant on supplying fresh pork and losing the hard-won share of the processed pork market. They prevent the industry from being able to recover from the increased costs of production caused by, inter alia, the drought.

There is a direct link between imports and domestic wholesale pork and farm pig meat prices – confirmed by economic modelling provided with this submission.

**Safeguards are entirely justified for the industry.**

Safeguards will provide the breathing space required by the industry to structurally adjust. The PC determined in 1998 that Safeguards were warranted for the pork industry. The justification has increased since then, as imports have surged and the damage from them has mounted.

Subsequent developments in WTO case law do not change this situation. The PC has cited the US Lamb case as suggesting the definition of the domestic industry entitled to safeguard measures ( producers of "like" or "directly competitive" products) may have narrowed to exclude Australian pig producers from forming part of the industry affected by import damage. APL refutes this totally.

The US lamb case did not address the definition of an industry as being one that produces products that are "directly competitive" to imports, which the Australian pig producers do. Furthermore, its consideration of "like products" was made with reference to the

specific industry at issue, the US lamb industry. The Australian pork industry is very different. It is almost totally integrated compared with the US lamb industry. Pigs are either owned by primary processors, or producers commonly own the pigs beyond the point of slaughter. Pig producers directly compete with imports of pork.

Expert WTO legal advice confirms this and is provided with this submission.

**Safeguards are the only means of addressing the injury.**

To provide the breathing space required, respite from the economic pressure of surging imports is required. The flow of imports can be reduced in the immediate term by the imposition of temporary safeguard controls. These can be imposed under WTO rules if there is clear evidence that imports have caused or are threatening to cause damage that would be difficult to repair. That case exists today.

The key factor causing damage to the industry is the rise in imports at prices that are predominantly well below domestic levels. APL urges the PC to recommend that a tariff be established that will account for the average seasonal gap in the price between imported and domestic legs and middles.

Based on publicly available data this means an estimated tariff of 62 percent for legs and a tariff of 48 percent for middles. This should apply for 200 days, following which full safeguards should apply at the above rates phasing down to the end of the four year period.

Knowledge that the measures are to be phased out within four years will create incentives for the industry to select its preferred form of restructuring. Further non-border measures to complement the safeguards and support the adjustment process are sought. These will be outlined in a subsequent submission to the PC's report on full safeguards.

The PC has requested that Inquiry participants provide data and other evidence in respect of a number of questions. This submission addresses each of the questions.

In summary, the questions posed by the PC and the key answers thereto are as follows:

***1. Have imports increased?***

Imports have risen in both absolute and relative terms. They have grown significantly over the past five years and accelerated over the past year. Their share of the market has increased by 40% in the last year. The share of imports of the processed pork sector has steadily increased since 2002-03 accounting for around 64 per cent of the processed pork market. They effectively threaten to take over the total market (short of a small volume restricted by quarantine restrictions on bone-in products).

***2. Was the increase in imports the result of unforeseen developments and WTO obligations incurred?***

There are several "unforeseen developments" occurring after the negotiation of the tariff concession in 1994 that together have resulted in increases in imports, and which were not "expected" at the time it was negotiated. One is changes in quarantine restrictions. Australian negotiators were entitled to expect that the government of the time had in place domestic quarantine rules which were not in violation of international rules. They did not foresee that resulting changes to that system would be as wide as they were from 1990 and the extent of market opening in the pork industry occurring as a result. If a shift to full market opening was foreseen, a longer period of adjustment to full competition through progressive reductions in tariffs would have been assured. This unforeseen circumstance also explains why other factors, such as the price gap between domestic and imported products, and increases in production costs had such a significant impact in import increases.

***3. Who are producers of like or directly competitive products?***

Pork producers and primary processors are producers of directly competitive products. There is a high level of common ownership of pigs between them, and because producers commonly own pigs after slaughter they carry the risks and directly face competition from imports of pork. Around 56 percent of the pigs killed in the Australian industry today are part of an integrated supply chain that includes primary processing and production, which tallies closely with the PC's estimate of vertical integration in 1998. As noted by the PC in 1998, more than 90 percent of all pigs grown are either sold under contract to downstream processors or butchers for the fresh meat market, or are produced by vertically integrated pork producers.

**The key point is that there is no identifiable separate domestic industry which only produces boned cuts of pork from purchased live pigs - processors and pig farmers are often one and the same**

***4. Has the industry suffered or is it likely to suffer, serious injury?***

Serious injury is being suffered. The injury done to date will continue to flow through given industry lags between decisions and production outcomes. Even if imports were to stabilize, the damage done to date threatens the critical mass of the industry. The industry has reached breaking point.

Given the interdependence of producers and primary processors on both the processed market and the fresh market, being left with the fresh market (and a residual amount of the processed market) to service will render a large part of the industry unviable (given the structure of the industry). The long term capacity of the industry will be permanently undermined. The critical mass of the industry required to rebuild and regain market share will be decimated.

***5. Are increased imports causing serious injury?***

Imports are causing the serious injury. There is a direct link between imports and domestic prices. Imports prevent the industry from recovering from the cost increases caused by, inter alia, droughts. Other factors cannot explain the damage caused. This was the case in 1998 – it is even more the case in 2007.

Continuation of current import trends will result in further injury to the primary processing sector. In the short term the profitability of the primary processing sector may benefit from the continued high level of imports and the resulting oversupply of pigs in the domestic fresh market market ( as producers quit the industry and sell off their breeding stock), suppressing domestic prices. However, in the longer term pig producers will not be able to maintain production of pigs in a market of prices below production costs, and the volumes supplied for abattoir, boning rooms, processing, and even into the premium export markets, will decline. Without doubt the competitiveness of abattoirs and boning rooms will decline and their costs will rise as capacity utilisation falls, and processing costs will rise until processing capacity is reduced to match the reduced volume of throughput. This will result in heavy job losses in pig production, slaughtering and boning in regional and rural Australia.

Pig producers and abattoirs and boning rooms will have to downsize accordingly to the point where they can operate profitably at these lower levels of production. The industry will be highly exposed to price movements in the fresh market, which will dominate demand.

It should be noted that with respect to both pig production and slaughtering and boning, there are considerable sunk costs. The industry is highly capital intensive and volume dependant. This differentiates the pork industry from many other agricultural industries. Strategies and investments to reduce costs of production and/or increase productivity will be abandoned due to the lack of investment capital, thus embarking the industry on a vicious circle. The costs of production are largely of a fixed nature, and this together with the low value of land tied up in pig production and slaughtering and boning rooms (with most facilities located away from urban areas for reasons of environmental regulations) mean that the costs of exiting the industry are high.

Once productive capacity is lost it will not be a simple matter of resources moving back into the industry in a seamless fashion at some point in the future in response to returns. The cost of restocking piggeries has a significant capital and cash flow impost to farmers. Mothballing and then re-commissioning processing facilities is also costly. Finding qualified labour is also a significant challenge.

***6. What safeguard measures would remedy serious injury?***

Urgent provisional safeguards are the only means of addressing the injury and provide the necessary breathing space in the in the immediate term. Delay is not an option given the threat to the critical mass of the industry.

Provisional safeguards should take the form of tariffs to close the gap between domestic and imported prices. Full safeguards should follow to ensure the industry has breathing space to undertake a planned adjustment to import competition. Other complimentary measures at this critical point would be redundant in their effectiveness if undertaken in isolation without a provisional safeguard.

### *7. What are the impacts on other parties?*

The Safeguards Agreement stipulates that "interested parties" (other than the domestic industry) must be given an opportunity to present their views, including as to whether the imposition of the safeguard measures would be in the public interest. However this does not require the PC to assess the impact of safeguard measures on interested parties, or to assess whether the measure is in the public interest in determining whether the requirements for imposition of measures have been met. Whether safeguards are justified is a legal question based on the requirements stipulated in the Safeguards Agreement.

Under the Australia-United States free trade agreement, Australia may exclude imports originating from the US in a safeguard action 'if such imports are not a substantial cause of serious injury or threat thereof.' Increases in imports from all sources (Canada, Denmark and the US) have caused serious injury to the domestic industry.

Both the absolute increases in the level of imports from the US and the magnitude of the share of that of all imports demonstrate that increases in US imports have clearly been of "great effect" in causing damage to the industry. Based on current levels of increases, they would also constitute a substantial cause of any threat of injury. It is unlikely therefore that imports from the US could be excluded from any safeguard actions taken by Australia.

APL will address the remaining terms of reference for this inquiry concerning the recent changes in the structure and operating methods of the industry and whether any immediate actions could be taken to complement the activities of the Pork CRC in order to alleviate the impact of high prices and restricted availability for feed grains in a subsequent submission as advised to the Commission on 26 October 2007. It will also address the complementary measures which it considers necessary in support of full safeguards in a subsequent report.

# 1. Have imports increased?

## 1.1 Liberalisation of the Australian market for pork

The Australian market for pork has been liberalised in two ways since the mid 1990s: through removal of tariff protection in the WTO, and through progressive relaxation of quarantine controls.

The Australian market for pork was first liberalised through commitments by Australia during the Uruguay Round of trade negotiations, which established the WTO, in 1994. Australia accepted a bound tariff rate of zero on imports of pigmeat under the WTO Agreement on Agriculture, effective from 1 January 1995. Liberalisation was undertaken without adjustment assistance or any form of compensation.

Between May 1990 and May 2004, quarantine restrictions against imports have been progressively reduced. Before 1990, only imports of canned hams were allowed entry into Australia. These measures reflect decisions by the Australian Government to relax quarantine controls to allow the import of frozen, uncooked pigmeat from Canada. In 1992 these restrictions were strengthened requiring imported frozen pigmeat to now be boned prior to export and to be used for processing in Australia. Most recently, following quarantine changes in 2004, imports of pork from the United States (US) have augmented those from major pork exporting countries like Canada and Denmark (Refer to Table 1 below).

Prior to liberalisation of tariffs and relaxation of quarantine restrictions, volumes of imports were small.

## Table1. Import Revisions

| Year/Period | Event |
|---|---|
| 1990 | • **May 1990**: Imports of uncooked, unfrozen pigmeat are permitted from the South Island of New Zealand.<br>• **July 1990:** Revision of import regulations allowing frozen and uncooked Canadian pig meat imports into Australia. Prior to 1990, only canned hams were permitted as imports. |
| 1992 | • **Late 1992**: **Import regulations strengthened** requiring all imported frozen pig meat to be boned prior to shipment and processed (cooked) on arrival under quarantine control. The imported meat is used for further processing in Australia. |
| 1996 | **May 1996**: **Canada** permitted to export chilled, boned pork cuts for further processing (cooking) in Australia. |
| 1997 | **November 1997**: **Canada** permitted to export cooked, de-boned pigmeat; **Denmark** permitted to export uncooked, de-boned pigmeat to be processed (cooked) on arrival under quarantine control. |
| 1998 | • Work on the Import Risk Analysis commences on 26 May 1998. Panel established to conduct a risk analysis, following requests from: Brazil, Canada, Chile, the EU member states, Hungary, Republic of Korea, Mexico, New Zealand, South Africa, Taiwan; and The United States.<br>• Productivity Commission Inquiry into Pigmeat Safeguards is announced by the Federal Government. |
| 2001 | • Reduced pork supply due to FMD impact ex Europe;<br>• Issues Paper released for the Import Risk Analysis on January 8, 2001 |
| 2004 | **Revision of import regulations:**<br>• **February 19, 2004**: Biosecurity Australia releases the IRA for pigmeat.<br>• **May 10, 2004**: Director of Animal and Plant Quarantine made a determination setting out new quarantine requirements for the importation of pig meat, **allowing imports from the U.S.**<br>• **9 July 2004**: Australian Pork Limited files legal action in the Federal Court Registry, aimed at preventing any reduction in quarantine regulations which could allow the entry of the disease, Post Weaning Multi-Systemic Wasting Syndrome (PMWS). A Directions Hearing of the application had been set down for **10 August, 2004**. |
| 2005 | • **27 May 2005**: Litigation in the Federal Court successful in the first instance before Mr. Justice Wilcox, handing down judgement.<br>• **20 June 2005:** the Commonwealth lodged an Appeal with the Federal Court against the original decision of the Court.<br>• **16 September 2005**: the Full Bench of the **Federal Court overturns Justice Wilcox' determination**. |
| 2007 | Countries that now have permission to export pigmeat de-boned for further processing into Australia:<br>• Canada (Cooked and uncooked)<br>• Denmark (Cooked and uncooked)<br>• United States (Cooked and uncooked)<br>• Finland (Uncooked)<br>• Sweden (Uncooked) |

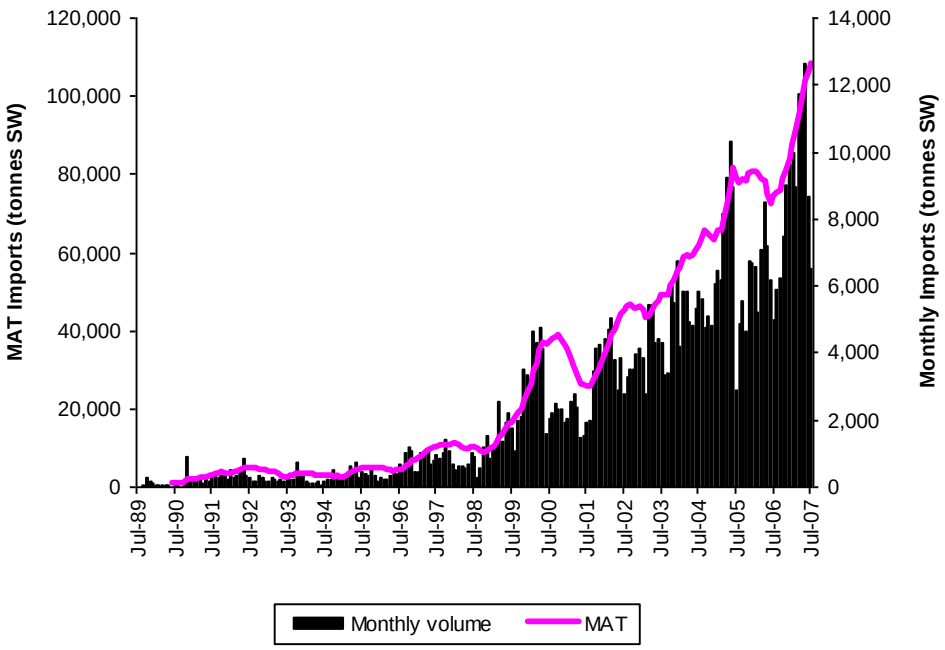
## 1.2 Relentless increases in imports

1.2.1 Absolute increases in imports since liberalisation

In 1990-91 imports of pork were negligible, totalling around 3,000 tonnes. By 2000-01, within five years following the market opening, imports rose to around 25,000 tonnes. The next five years saw imports rise to around 80,000 tonnes by 2005-06. In 2006-07, imports surged to nearly 110,000 tonnes.[1]

Imports increased markedly in absolute terms between 1998, the time of the last Safeguards Inquiry by the Productivity Commission, and 2007. The rise of imports since 1998 is depicted in Chart 1, below.

**Chart 1. Australian pork imports, monthly and moving annual total (MAT), 1989 – 2007**




*Source: Australian Bureau of Statistics (ABS)*

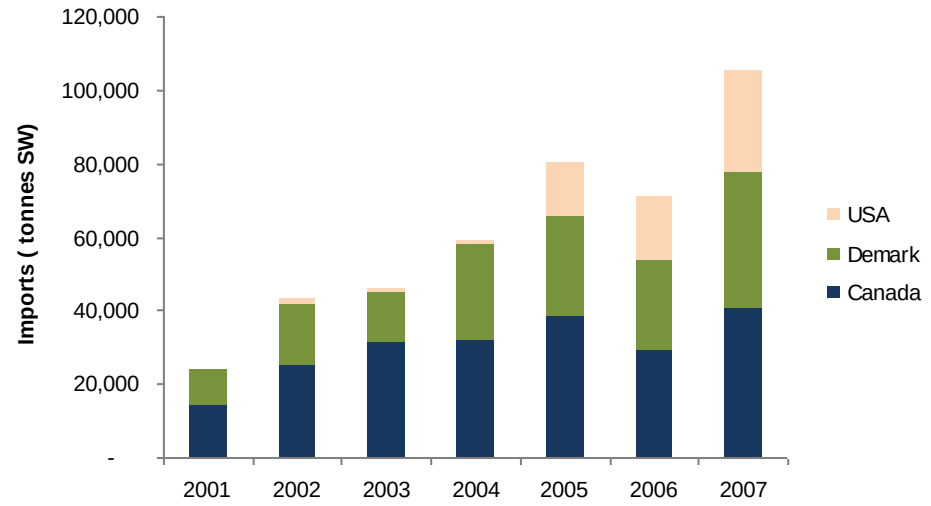
[1] Figures referred to are by shipped weight.

1.2.2 Absolute increases in imports more recently

Imports have also risen significantly over the past few years, and again very markedly in the most recent year, 2006-07. Imports more than doubled over the past five years. In the most recent year they rose from 126, 889 tonnes carcase weight equivalent (CWE) in 2005-06 to 190,311 tonnes in 2006-07.

Imports have thus been on a steep upward trend almost continuously since liberalisation of the market. This upward trend has continued to be evident over the past five years, and, has accelerated over the past year.

**Chart 2. Australian pork imports, selected countries, 2001 – 2007**




*Source: ABS*

It should also be noted that increased imports from the US have also added to the volume of imports and hence the damage experienced by the industry. Imports from the US have augmented historical levels of imports from Canada and Denmark rather than substituted for them. This is evident from Chart 2 above.

1.2.3 Increases in import penetration since liberalisation

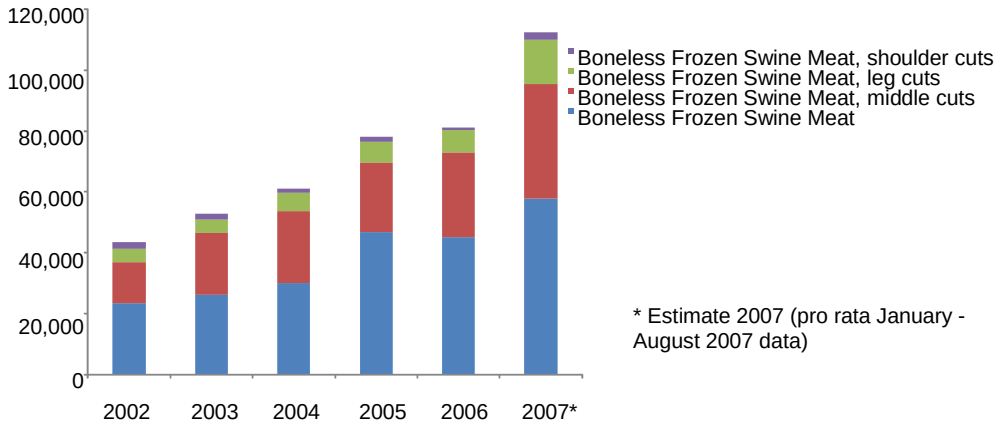
Imports have not only increased in absolute terms, but have also taken an increasing share of the Australian pork market relative to production and consumption since liberalisation. This share has surged in the recent past.

Various calculations have been made to measure the share of the Australian market accounted for by imports and how it has changed over time. All calculations record a substantial increase in import penetration.

There has clearly been a meteoric increase of imported pig meat: the August 2007 annual forecast being over 126 percent of the 2002 total a as shown in Chart 2 above[2]. It is also clear that the rate of growth has sharply accelerated during 2007 with the year to August 2007 import rate extrapolating to a 40 percent growth over 2006.

Despite the rapid growth in imports, particularly in last few months, the types of pork product being imported has shown no significant change as shown in Chart 3 below.

**Chart 3. Volume of major import cuts (tonnes). 2002-2007**

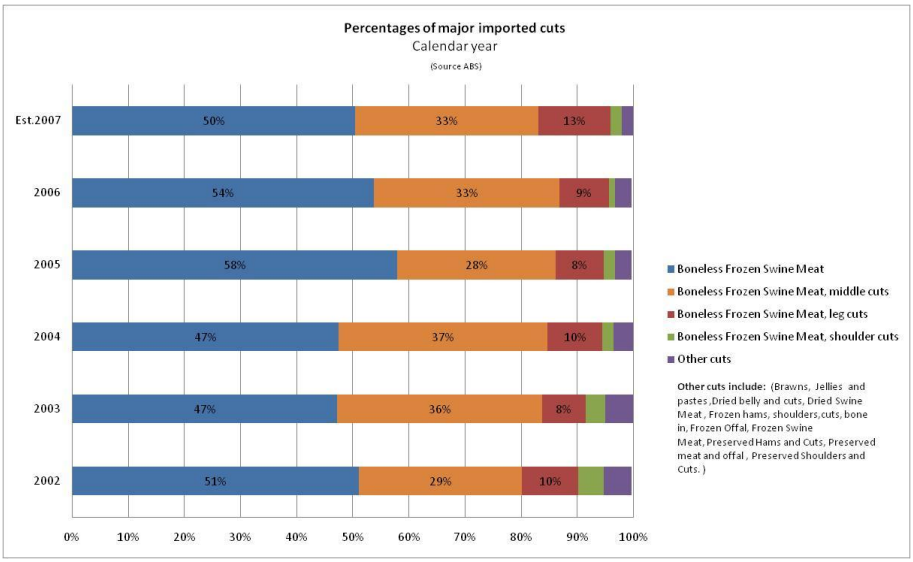



*Source: ABS*

Note: The size of Non-specific Boneless Frozen Swine meat is the consequence of import regulation classifications.

[2] Based on import figures from Table 2.

**Chart 4. Percentage of major import cuts. 2002-2007**




*Source: ABS*

Over the past five years imports have been predominantly comprised boneless frozen meat (legs) and middles as Chart 4 above indicates.

1.2.4 Increases in import penetration more recently

Import penetration measured through the share of imports of total apparent consumption (i.e. imports' share of domestic production plus imports minus exports) has also markedly increased. On this basis, the share of imports in consumption, which was negligible prior to the opening of the market, reached around 20 percent in 2002-03 and by 2006-07 it rose to 34 percent.

The relative rise in the share of imports is marked in the most recent year, 2005-06 to 2006-07, when the share of imports of apparent consumption rose from around 26 percent to 34 percent – an increase of 8 percentage points over just one year. This contrasts with the 8 percentage point rise in import penetration over the previous 3 years. Clearly there has been a marked acceleration in the pace of import penetration. Table 2 below shows this trend.

**Table 2 . Import penetration of the Australian pork market, 2002-2007 (000 tonnes CWE)**

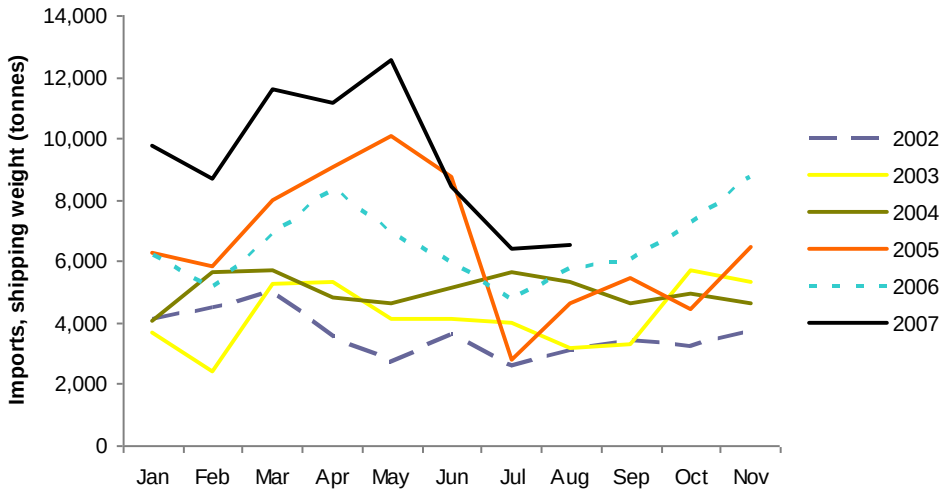
| Year | Imports (A) | Domestic production (B) | Exports (C) | Apparent consumption (A+B-C) | Imports % production | Imports % apparent consumption |
|---|---|---|---|---|---|---|
| 2002-03 | 73 | 418 | 83 | 408 | 17 | 18 |
| 2003-04 | 90 | 405 | 69 | 426 | 22 | 21 |
| 2004-05 | 128 | 388 | 61 | 455 | 33 | 28 |
| 2005-06 | 112 | 388 | 63 | 437 | 29 | 26 |
| 2006-07 | 165 | 381 | 60 | 486 | 43 | 34 |

*Source: ITS Global analysis of data from APL*

### 1.3 Import prospects

The level of imports in recent months has been equal to or greater than the previous record level of imports, and above the levels of last year (sees Chart 5, below). If the pattern of imports experienced in recent months is maintained, monthly imports approaching Christmas 2007 could well approach (or even exceed) the 12,000 tonnes that occurred in the early parts of this year.

**Chart 5. Australian monthly pork imports, 2002-2007**

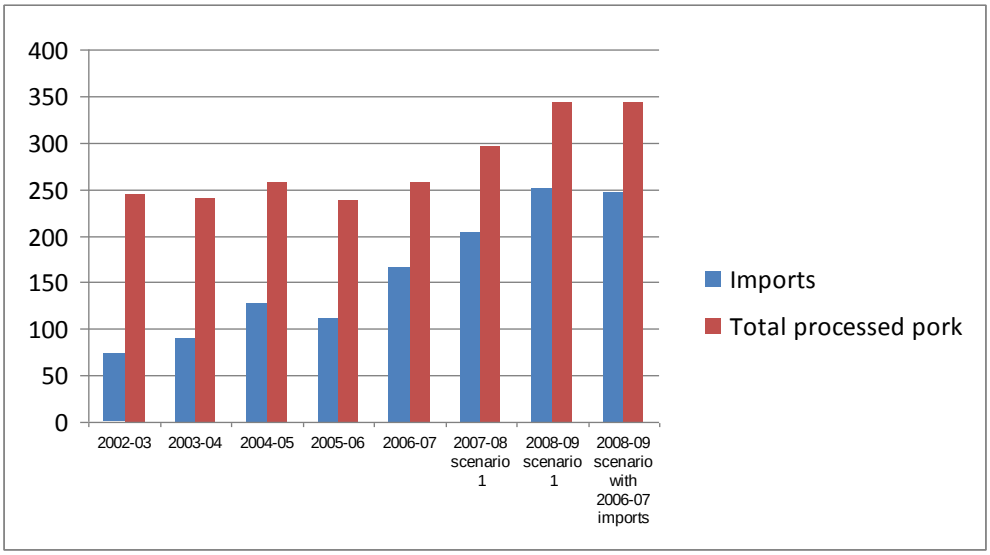



*Source: Australian Pork Limited (APL)*

As the penetration of imports increases, it threatens to capture the whole processed market in between one and two years (Chart 6 below). Whilst quarantine barriers remain against imports of bone-in products, some proportion of the processed market will need to be supplied by domestic product. However given the interdependence of producers on both the processed market and the fresh market, being left with the fresh market (and a

residual amount of the processed market) to service will render a large part of the industry unviable (given the structure of the industry).

**Chart 6. Imports of processed pork as share of production of processed pork, 2002-03 to 2006-07, and projected increase under two scenarios**




*Source: ITS analysis from APL data*

Scenario 1 assumes imports growing at the average rate since 2002-03;
Scenario 2 assumes imports growing at the rate they did in 2006-07
Note: Assumes total processed pork remains same in future years as in 2006/07.

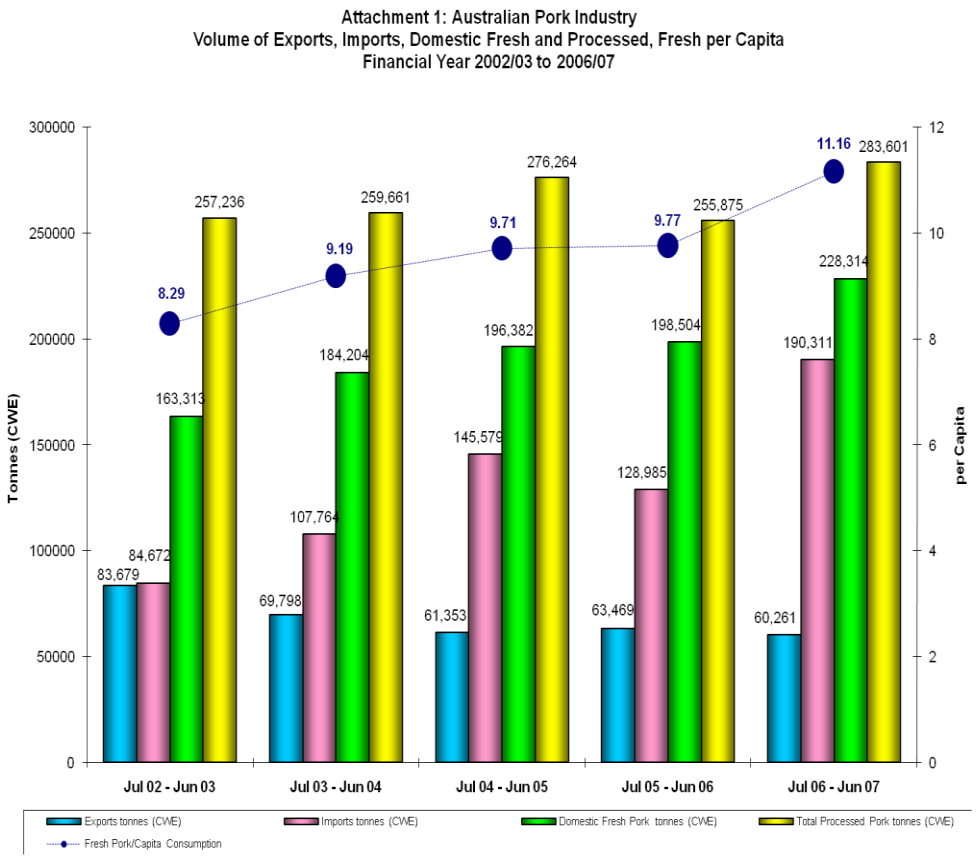
This may well result in "overshooting", i.e. reductions in breeding and productive capacity to such an extent that the long term capacity of the industry will be permanently undermined. The critical mass of the industry required to rebuild and regain market share will be decimated. At considerable risk are the substantial gains that have been made by the industry to improve its competitiveness and productivity, the phenomenal increases achieved in fresh pork per capita consumption and indeed the ongoing investments in these areas to improve our efficiency and as embodied for example in the establishment and work of the Pork CRC. Since 2004, the industry has worked to reshape itself, driving change where we have competitive advantages and strategically repositioning itself.

The industry has not been marking time nor has it relied on government handouts. Instead, over the last few years the Australian pork industry has undertaken a number of initiatives and made significant key investments to improve its competitiveness. These are explored fully in our next submission and include but are not limited to the Pork CRC; technology increasing fresh pork demand; improving carcase value and reducing supply chain costs; contracts and measurements systems; building industry capability and enhancing sustainability.

However, the damage to the industry resulting from imports has been so pervasive to date that this damage will continue irrespective of any short to medium slow down in the rate of imports. Indeed an examination of the econometric analysis conducted by Stuart Mounter and Albert Wijeweera (University of New England) November 2007, "The Impact of Pigmeat Imports on Australian Pigmeat Prices" clearly shows that this damage to the industry has been mounting for some time (refer to Annex II).

Based on current import trends, with production forecast to continue to decline and as producers continue their exit from the industry or reducing their breeding herd, it is anticipated that the current supply to the market will fall below existing levels, increasing fresh pork prices. This would not only push some consumers out of domestic pork consumption, but would also damage pork's current brand value position, causing long term damage to pork volume.

**Chart 7. Australian pork industry, selected data (tonnes), 2002/03 – 2006/07**




*Source: APL*

Chart 7 illustrates the growth in domestic fresh pork per capita consumption set against imports, exports and domestic fresh and processed pork production over the last five years. It demonstrates that in parallel with this industry driven growth in fresh pork consumption there has been significant growth in imports while exports have remained relatively stable. Over the last five years the pork industry has aggressively marketed Australian pork, achieving consistent rapid growth in fresh pork consumption over the last five years and resulting in a 35% increase in fresh pork consumption (or 65,000 tonnes CWE). However as already shown it has been imports that have taken an increasing share in the growth of the Australian pork market relative to production and consumption.

## 2. Was the increase in imports the result of unforeseen developments and the result of WTO obligations incurred?

### 2.1 The requirement of "unforseen developments"

2.1.2 The requirement to demonstrate unforeseen developments

It is clear that in order to impose safeguard measures that are consistent with WTO obligations, WTO members must comply with both the provisions of GATT Article XIX and the Agreement on Safeguards. The provisions of Article XIX: 1(a) of the GATT 1994 and Article 2.1 of the Agreement on Safeguards together set out the conditions for applying a safeguard measure under the WTO.

Article XIX of the GATT requires that before a safeguard measure can be applied, a Member must demonstrate, as matter of fact, that as a result of obligations incurred under the GATT, it finds itself confronted with developments it had not foreseen when it incurred that obligation.[3] Article XIX:1(a) states:

> If, as a result of unforeseen developments and of the effect of the obligations incurred by a Member under this Agreement, including tariff concessions, any product is being imported into the territory of that Member in such increased quantities and under such conditions as to cause or threaten serious injury to domestic producers in that territory of like or directly competitive products, the Member shall be free, in respect of such product, and to the extent and for such time as may be necessary to prevent or remedy such injury, to suspend the obligation in whole or in part or to withdraw or modify the concession.

The WTO has noted that Article XIX has been clarified and reinforced by the Agreement on Safeguards. In order to give legal effect to both the GATT and the Agreement on Safeguards, the provisions of each apply cumulatively.

2.1.3 The concept of unforeseen developments

WTO jurisprudence on GATT Article XIX provides guidance on the term "unforeseen developments".

[3] Confirmed by the WTO Appellate Body in *Korea Dairy* and in *Argentina Footwear* cases.

- Developments must be unexpected at the time that the obligation under the GATT was negotiated. In the *Argentina Footwear (EC) case*, the AB stated that the 'the ordinary meaning of the phrase "as a result of unforeseen developments" requires that the developments which led to a product being imported in such increased quantities and under such conditions as to cause or threaten to cause serious injury to domestic producers must have been "unexpected"'.[4]

- The requirement of "unforeseen developments" does not establish a separate "condition" for the imposition of safeguard measures, but describes a certain set of "circumstances" which must be demonstrated as a matter of fact in order for a safeguard measure to be applied.[5]

- The remedy provided by Article XIX is of an emergency character and is to be invoked only in situations when, as a result of obligations incurred under the GATT 1994, a Member finds itself confronted with developments it had not "foreseen" or "expected" when it incurred that obligation. In their decision in *Argentina Footwear (EC),* the WTO Appellate Body referred to a GATT Panel Report to confirm their analysis, which stated that "unforeseen developments" should be interpreted to mean developments occurring after the negotiation of the relevant tariff concession which … would not be reasonable to expect that the negotiators of the country making the concession could and should have foreseen at the time when the concession was negotiated.'[6] Notably in that case, it was determined that the extent of change could not have been foreseen at the time the tariff concession was made.[7]

- The investigation need not point to only one particular unforseen development. The Panel in *US-Steel*[8] noted it is commonly appropriate to examine a

[4] Appellate Body Report on *Argentina - Footwear (EC)*, para. 91. See also Appellate Body Report on *Korea - Dairy*, para. 84.

[5] Appellate Body Report in *Argentina - Footwear (EC)*, para. 92. See also Appellate Body Report on *Korea - Dairy*, para. 85

[6] This interpretation was proposed by the representative of Czechoslovakia, and was accepted by the majority of the Working Party with the exception of the United States. Appellate Body Report in *Argentina - Footwear (EC)*, para. 96. See also Appellate Body Report on *Korea - Dairy*, para. 89.

[7] Appellate Body Report on *Argentina - Footwear (EC)*, para. 91. See also Appellate Body Report on *Korea - Dairy*, para. 84.

[8] Panel Report on *US-Steel*. Para 10-89.

combination of factors that together explain why certain unforeseen circumstances result in serious injury.

The above conditions must be demonstrated before the safeguard measure is applied and included in the report of the competent authorities. In *US – Lamb*, the AB held that "unforeseen developments" is a circumstance whose existence must be demonstrated as a matter of fact and must feature in the published report of the investigating authorities.[9]

While the jurisprudence has identified these elements, they must be read in the context of the standard of review that is applied in any challenge to domestic measures. A safeguards enquiry covers a range of complex economic and factual data. The aim of the WTO is not to promote incessant challenges to permitted domestic remedies. In *US-Steel,*[10] the Panel observed that the standard of review in a safeguards challenge is not *de novo* review, but rather, an analysis of whether the domestic decision-maker provided a "reasoned and adequate explanation."

**2.2 What are the unforeseen developments that have led to increased imports of pig meat? Why could they not have been reasonably foreseen or expected?**

Like many WTO Agreements, the Agreement on Safeguards seeks to achieve a certain economic result. In most cases, provisions of WTO Agreements serve to constrain adoption of measures which have a protective effect. This is not the case with the WTO safeguard provisions. Their aim is to provide breathing space from a level of competition from imports which was unforeseen to provide time to readjust to the more competitive environment created by the reduction of trade barriers. Specifically, the Agreement provides for the reintroduction of protection on a temporary basis and on specified terms.

In the case of Article XIX and the Agreement on Safeguards, the extent to which they are successful in meeting their economic purpose will be measured by interpretation of their provisions in a way which permits protection to be introduced in the manner envisaged in the provisions. Where interpretation of provisions is necessary to decide whether or not safeguards should be applied, it is also important that the economic intent of the agreement guides interpretation. The WTO Appellate Body, in its consideration of Article

[9] Panel Report on *Chile - Price Band System*, para. 7.134

[10] Panel Report on *US-Steel.* para 10-38.

XIX in *Argentina - Footwear (EC)*, held that the object and purpose of Article XIX was relevant to its interpretation.

In this case, several "unforeseen developments" occurring after the negotiation of the tariff concession in 1994 (the binding at zero) together have resulted in increases in imports that were not "expected" at the time it was negotiated. Unexpected factors, such as the price gap between imported and domestic products (brought about by persistent drought and rising production costs), in combination with quarantine factors, have all resulted in increases in imports.

There have been significant changes in quarantine restrictions affecting the Australian pork industry since 1994. While it can be assumed that Australia foresaw the need to ensure its quarantine system was in compliance with the WTO SPS Agreement and would need to be based on a risk management approach to quarantine back in 1994 when the tariff was bound at zero, it would not be reasonable to expect that Australian negotiators foresaw at the time the extent of compliance or change that was required. Negotiators were entitled to expect that the government of the time had in place domestic quarantine rules which were not in violation of international rules. There was an express or implied promise to industry that quarantine controls were effective and valid. This was not the case.

They did not foresee that resulting changes to that system would be as wide as they were from 1990. While it is reasonable to assume that quarantine changes would affect imports of pork in some way, the extent of market opening occurring as a result (which was to completely open the market) was not. This did not become apparent until Canada challenged Australia's quarantine policy as it applied to pork. Arguably if a shift to full market opening was foreseen, a longer period of adjustment to full competition through reductions in tariffs would have been assured.

This unforseen circumstance also explains why the other unexpected factors, such as the price differential between domestic and imported products, had such a significant impact. This was referred to by the PC in its 1998 inquiry. The PC noted that the extent of the increased differential between domestic and import prices between 1994 and 1998 was not foreseen. This price gap had not been foreseen because the effect of the drought on producer numbers and pigmeat production levels had not been foreseen. This was based on the fact that Australia's acceptance of a bound tariff rate of zero on imports of pigmeat in 1994 had been taken at a time when (a) the major processors had given assurances that

they would not use imported product, and (b) it might reasonably be expected that the price difference between imports and local products would narrow.

The PC noted that between 1996–97, import volumes (under sub-heading 0203.29) increased to 8,550 tonnes (from 3,130 tonnes in 1995–96), and remained at just under 8,000 tonnes in 1997–98, and that this significant increase arose mainly because a major manufacturer changed its policy (probably due to the increased differential between domestic and imported prices) and because some of its competitors were now importing. At the time, it was anticipated that Canadian pork prices would rise, while Australian production costs would fall when the drought, which existed at the time, ended. Both of these factors 'would help to reduce the incentive to import.'[11] It was not expected that quarantine rules would significantly change this.

This argument remains relevant today. The drought has persisted and production costs have risen. The price differential between domestic and imported products remains. The econometric analysis conducted by Mounter and Wijeweera (UNE) clearly shows a strong link between pigmeat import levels and wholesale and farm pigmeat prices (refer to Annex II).

As a result, imports, free from quarantine controls, have increasingly entered the market. The PC noted in its inquiry in 1998 that that the Australian market was opened to imports of pig meat from Canada (under certain quarantine conditions) in mid-1990. Between 1990–91 and 1995–96, import volumes increased to, and stabilised at, around 3,000 tonnes per year. Today, imports have increased even more to nearly 110,000 shipped weight tonnes.

All of these factors taken together, against the backdrop of the relaxed quarantine measures, constituted an unexpected and unforseen confluence of events."

The government must share responsibility for the impact of these developments. Safeguards measures are for temporary adjustment in the face of unforeseen circumstances. They are an emergency action permitted under WTO law. Given that it was the government that was wrong in its assessment of the validity of its quarantine controls and its expectations of the impact of other factors, and that it is the government that

[11] Productivity Commission (1998) *Pig and Pigmeat Industries: Safeguard Action Against Imports*, Inquiry Report, Report No. 3, 11 November 1998 p 29-30.

negotiates safeguards concessions, it is only fair that it use such measures to support the industry.

## 3. Defining the domestic industry: who are producers of "like" or "directly competitive" products?

The goods under review in this inquiry are imports of frozen pig meat falling within tariff subheading 0203.29 of the Australian Customs tariff. These are the same goods that were under review in the 1998 safeguards inquiry.

The WTO Safeguards Agreement defines the domestic industry as 'the producers as whole of the like or directly competitive products operating within the territory of a member, or those whose collective outputs of the like or directly competitive products constitute a major proportion of the total domestic production of those products.'[12]

Defining the domestic industry therefore requires determining:

- What products are "like" or "directly competitive" with imports of frozen pig meat?; and
- Who are the "producers" of these products?

Recent judgments in WTO disputes have provided guidance on making these determinations.[13]

- The WTO AB noted in *Japan Alcoholic Beverages* (1996) that the term "like products" will vary between different provisions of the WTO Agreements. They noted that there can be no one precise and absolute definition of what is "like". They stated that 'the concept of "likeness" is a relative one that evokes the image of an accordion. The accordion of "likeness" stretches and squeezes in different places as different provisions of the WTO Agreement are applied. The width of

[12] Safeguards Agreement, Article 4.1(c)

[13] In the *US Lamb* case, the Appellate Body (AB) affirmed that the legal basis for imposing a safeguard measure exists only when imports of a specific product have prejudicial effects on domestic producers of products that are "like or directly competitive" with that imported product. They noted that it would be a clear departure from the text of the agreement if a safeguard measure could be imposed because of the prejudicial effects that an imported product has on domestic producers of products that are *not* "like or directly competitive products" in relation to the imported product. They then added, that the first step in determining the scope of the domestic industry is the identification of the products which are "like or directly competitive" with the imported product. Only when those products have been identified is it possible then to identify the "producers" of those products.

the accordion in any one of those places must be determined by the particular provision in which the term "like" is encountered as well as by the context and the circumstances that prevail in any given case to which that provision may apply.'[14]

- The Appellate Body in *Canada - Periodicals*, (1997) reiterated ( its finding in *Japan - Alcoholic Beverages II*) that '[T]he proper test is that a determination of "like products" for the purposes of Article III:2, must be construed narrowly, on a case-by-case basis, by examining relevant factors including: (i) the product's end-uses in a given market; (ii) consumers' tastes and habits; and (iii) the product's properties, nature and quality.'[15]

- The Appellate Body in *Japan - Taxes on Alcoholic Beverages II* (1996) in considering Article III: 2, stated that "directly competitive or substitutable" is a broader category than "like products". How much broader (than like products) that category of "directly competitive or substitutable products" may be in a given case is a matter for the panel to determine based on all the relevant facts in that case.[16] The Appellate Body added that distinguishing between "like products" and "directly competitive or substitutable products" under Article III: 2 is a discretionary decision that must be made in considering the various characteristics of products in individual cases.[17]

- In *Korea - Alcoholic Beverages* (1999), the Appellate Body considered the "object and purpose" of Article III in its interpretation of the term "directly competitive or substitutable".[18] In its 1998 inquiry, the PC also referred to the object and purpose of Article 11 of the GATT on the one hand, and the Safeguards Agreement on the other. The Commission pointed out that the objective of the Safeguards Agreement - which is to permit actions against imports which cause serious injury to the domestic industry - does not warrant an interpretation of the term "directly

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[14] Report on *Japan - Alcoholic Beverages II*, p. 21.

[15] Appellate Body Report on *Canada - Periodicals*, pp. 21-22.

[16] *(footnote original)* Appellate Body Report on *Japan - Alcoholic Beverages II*, p. 25.

[17] Appellate Body Report on *Japan - Alcoholic Beverages II*, pp. 19-21.

[18] The object and purpose of Article III is the maintenance of equality of competitive conditions for imported and domestic products. It is, therefore, not only legitimate, but even necessary, to take account of this purpose in interpreting the term 'directly competitive or substitutable product'." Appellate Body Report on *Korea - Alcoholic Beverages*, para. 127.

> competitive" which is so narrow as to run counter to this. An interpretation which resulted in a large group of producers, who were experiencing injury as result of imports, being excluded from safeguard action would do so. Further to this, the PC cited US legislation which interpreted the term "directly competitive with" in terms of the potential economic effects of imports.[19]

Notably the Productivity Commission has raised a question as to whether the Panel and Appellate Body decisions in *US – Lamb* provide any binding rulings as to the scope of the "domestic industry" that may be considered under the current inquiry. In particular, the key question is whether that jurisprudence prevents the Productivity Commission from holding that producers of live pigs and pig carcases can be considered as part of the relevant industry.

Nothing in the jurisprudence of that or any other WTO case leads to that result. The case was a challenge to a USITC decision imposing safeguards. The USITC only made a determination in relation to "like products". It did not address itself to the alternative criterion for inclusion of a producer within the relevant industry, namely, that pertaining to producers of "directly competitive" products. Comments by the Panel and the Appellate Body about the "like product" test have no relevance to a determination of the "directly competitive" standard. That was made abundantly clear by the Panel in *US – Lamb* and was not disputed by the Appellate Body:

APL has obtained expert legal advice on this matter and a copy of that advice is attached (refer to Annex I). That advice addresses all relevant issues raised by the Commission in its Issues Paper.

### 3.1 What products are "like" or "directly competitive" with imports of frozen pig meat?

#### 3.1.1 Determining like or directly competitive products

Relevant principles of international treaty interpretation govern the interpretation of what is "like" or "directly competitive" in terms of Article 4.1 (c) of the Safeguards Agreement. WTO jurisprudence can provide some guidance, though ultimately the determination will depend on the circumstances and facts of the particular case at hand.

[19] Productivity Commission (1998) *Pig and Pig meat Industries: Safeguard Action Against Imports*, Inquiry Report, Report No. 3, 11 November 1998, p 21-22.

There is little jurisprudence on Article 4.1 of the Safeguards Agreement itself. The *US Lamb* case is the only case that deals directly with it. In that case, the "like product" was "lamb meat", which was the imported product with which the safeguard investigation was concerned.

According to the independent legal advice obtained by APL, the case cannot be seen as any kind of limiting authority as to a "like product" analysis, although comments as to likeness would be relevant if a safeguard action could not be separately mandated under the "directly competitive" standard. In the context of its "like product" analysis, the Panel in *US-Lamb* made very specific factual findings that lamb production in the United States was not highly vertically integrated at that time. The Panel's conclusions that identified violation of the "like products" standard by the USITC, based in part on such factual findings, cannot *a priori* have anything to say about a different industry in a different country at a different time.

Most crucially, the Appellate Body in the Lamb decision also did not address the key question of the interpretation of "directly competitive products". It simply could not do so as it also noted that the USITC did not find that there were any such products. It expressly stated that '(t)he term "directly competitive products" was not at issue in the disputes as none were alleged to exist in that case.

According to legal advice, the standard to be applied for "directly competitive products" is broader than that for "like products". The proper interpretation of the "directly competitive" standard should be that it constitutes a test of direct substitutability. Only a robust analysis of the true market situation in Australia can lead to a valid determination as to which products directly compete with, and are substitutable for, each other.

APL contends that to prevent such an analysis based on some misreading of WTO jurisprudence, would itself be a violation of the standards and would be a failure by the Productivity Commission to comply with its legislative mandate.

Again the Commission should refer to Annex I which outlines the implications of the *US-Lamb* case.

3.1.2 Like or competitive products to imports of frozen pig meat

The issue is whether fresh and frozen pig meat can be considered to be "like" or "directly competitive" products. In particular, is the degree of integration in the pig meat industry relevant for determining whether processed imports have a directly competitive relationship with fresh pigmeat.

In its 1998 inquiry, the PC considered that frozen and fresh pigmeat were "like" products. This was based on the view that freezing did not change the nature of the imported products compared with pork produced in Australia in any way. The PC also affirmed that slight differences in quality and cut did not prevent the products being "like".

The Commission also contended that frozen pork cuts and pig carcasses or boned cuts were directly competitive products, despite being at different stages of processing. This instead reflected quarantine requirements rather than fundamental differences between the products or their end uses. Slaughtering and boning operations are service inputs to the pig meat production process. They pointed out that pigs were rarely grown for any purpose other than the production of pig meat and that pig meat production constituted a major part of the value-added of boned cuts. Consequently, as any changes in the market for pig meat would directly affect the demand for pigs and the price received by pig producers, imports of boneless pork would be expected to affect the demand for carcasses supplied by pig growers to local processors in much the same way as would imports of live swine or carcasses.

APL considers that the reasoning of the PC in the 1998 inquiry remains valid. Frozen imports of processed pig meat and fresh processed imports, based on their particular characteristics, are like products for the purposes of Article 4.1 (c). The term "directly competitive products" is sufficiently broad such that processed imports and fresh domestic pig meat are "directly competitive products", based on both their end uses and their demand relationship.

As noted above, the *US-Lamb* decision did not set a standard which changes this assessment.

### 3.2 Who produces these products? Who are the "producers"?

3.2.1 Identifying the producers

In the *US- Lamb* case, the AB made it clear that, according to the clear and express wording of the text of Article 4.1(c), the term "domestic industry" extends solely to the 'producers... of the like or directly competitive products'.[20]

The AB noted that "producers" are those who grow or manufacture an article; those who bring a product into existence. This meaning is qualified by the second element in the definition of "domestic industry", which identifies the particular products that must be produced by the domestic "producers" in order to qualify for inclusion in the "domestic industry". The definition, therefore, focuses exclusively on the producers of a very specific group of products.

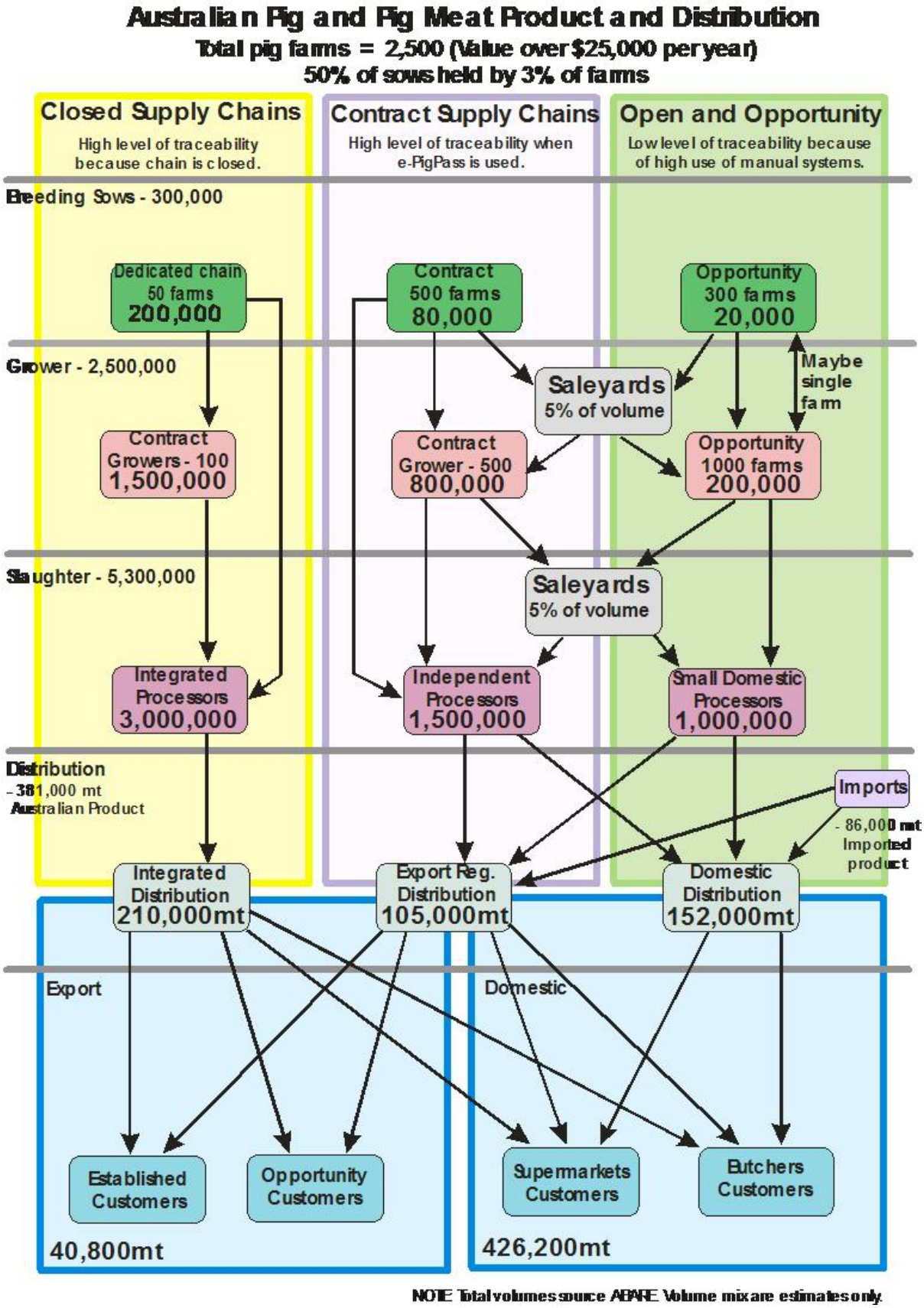
3.2.2 Producers of like and directly competitive pig meat products

The 1998 Safeguards Inquiry determined that, while the product imported is processed, both primary processors and pig producers (excluding downstream manufacturers of pork small goods) constituted the domestic industry. This reflected the integrated nature of the pork industry and the pattern of ownership of pig meat. According to industry sources, around 56 percent of the pigs killed in the Australian industry today are part of an integrated supply chain that includes primary processing and production, which tallies closely with the PC's estimate of vertical integration in 1998. As noted by the PC in 1998, more than 90 percent of all pigs grown are either sold under contract to downstream processors or butchers for the fresh meat market, or are produced by vertically integrated pork producers.

Diagram 1, "Australian Pig and Pig Meat Product and Distribution" below, provided by APL and verified by commercial sources, confirms the vertical integration of the industry as discussed above: of the total 5 million pigs slaughtered some 3 million are part of an integrated enterprise including production and primary procession, and shows that the remaining pigs sold for slaughter are sourced either through saleyards (5%), spot market or forward and general contracts.

[20] Appellate Body on *US - Lamb*, para. 84.

**Diagram 1**


Australian Pig and Pig Meat Product and Distribution
Total pig farms = 2,500 (Value over $25,000 per year)
50% of sows held by 3% of farms
Closed Supply Chains
High level of traceability because chain is closed.
Contract Supply Chains
High level of traceability when e-PigPass is used.
Open and Opportunity
Low level of traceability because of high use of manual systems.
Breeding Sows - 300,000
Dedicated chain 50 farms 200,000
Contract 500 farms 80,000
Opportunity 300 farms 20,000
Grower - 2,500,000
Saleyards 5% of volume
Maybe single farm
Contract Growers - 100 1,500,000
Contract Grower - 500 800,000
Opportunity 1000 farms 200,000
Slaughter - 5,300,000
Saleyards 5% of volume
Integrated Processors 3,000,000
Independent Processors 1,500,000
Small Domestic Processors 1,000,000
Distribution
- 381,000 mt
Australian Product
Imports
- 86,000 mt
Imported product
Integrated Distribution 210,000mt
Export Reg. Distribution 105,000mt
Domestic Distribution 152,000mt
Export
Domestic
Established Customers
Opportunity Customers
Supermarkets Customers
Butchers Customers
40,800mt
426,200mt
NOTE Total volumes source ABARE Volume mix are estimates only.

A high percentage of pork is owned by the growers until it reaches the stage where pig meat is eviscerated carcasses. Under contracted systems, growers are paid at the slaughter floor, based on sex, weight and P2 (AusMeat standards). At sale yards, ownership changes at the fall of the hammer. When sold under contract, the downstream customer generally assumes ownership of and pays for the pig *after* it has been slaughtered (the farmer sells a dressed carcass, not a live pig). The abattoir does not assume ownership of the pig, but rather provides a service input, at a fee (commonly referred to as a "service fee".) Processors then either cut and bone the carcass themselves or contract out this task to boning rooms. These cuts are sold subsequently as fresh pork or frozen meat or are processed into hams and small goods.[21] The PC has also undertaken to write to pigmeat processing industry with a view to confirming this and obtaining further information.

**The key point is that there is no identifiable separate domestic industry which only produces boned cuts of pork from purchased live pigs - processors and pig farmers are often one and the same.[22]**

It should not be assumed the AB ruling in the *US-Lamb* case nullifies this interpretation of the domestic industry. In that case the AB expressed scepticism that the degree of integration of production processes within an industry should have any bearing on the determination of the "domestic industry". It stated that they had "reservations about the role of an examination of the degree of integration of production processes for the products at issue". It reiterated that the determination of the "domestic industry" is based on the 'producers... of the like or directly competitive products'.

These comments in the AB ruling have neither juridical nor substantive application. There is no official doctrine of precedent in WTO jurisprudence. The system is not solely based on "common law" precepts.

The *US-Lamb* case should not even be seen as any kind of limiting authority as to a "like product" analysis. In its "like product" analysis, the Panel made very specific factual findings that lamb production in the United States was not highly vertically integrated at that time. The Panel's conclusions that identified violation of the "like products" standard by the USITC, based in part on such factual findings, cannot *a priori* have anything to say about a different industry in a different country at a different time. All that can be

[21] Productivity Commission (1998) *Pig and Pig meat Industries: Safeguard Action Against Imports*, Inquiry Report, Report No. 3, 11 November 1998, p 25- 26.

[22] *Ibid*, p 26.

concluded from the Appellate Body report is that it agreed with the Panel that live lambs and lamb meat were not like products on the facts as found by the Panel.

The structure of the lamb industry in question was not the same as the structure of the Australian pork industry in this case. The US lamb industry is not integrated like the Australian industry. Lamb is essentially traded as a fresh meat whereas pork's value is intimately related to both fresh and processed product. Only about 15 percent of lambs are sold or shipped through forward contracts, marketing agreements, custom feeding or custom slaughtered, or through packer fed/owned or internal transfer. [23] As already shown, the Australian pork industry comparable share is more than 90 percent (refer Diagram 1 above). Of the 15 percent in the US, less than 1 percentage point was sold through packer fed/owned or internal transfer, compared with the 50 percent plus estimates cited above for vertically integrated arrangements in the Australian industry.

More importantly, the *US-Lamb* case did not address the question of the alternative criterion for inclusion of a producer within the relevant industry, namely, that pertaining to producers of "directly competitive" products. Comments by the Panel and the Appellate Body about the "like product" test have no relevance to a determination of the "directly competitive" standard.

As noted above, WTO jurisprudence will focus the circumstances of the case in point. The focus must be on the identification of the products, and their "like or directly competitive" relationship, and not on the processes by which those products are produced.[24] The proper approach is simply to allow for evidence on a case by case basis as to what is directly competitive. The only important question of interpretation is first what is meant by "competitive" and secondly what limitations on that concept are sought to be imposed by the qualifier "directly". A test of substitutability as argued for above is supported by plain meaning, context and purpose. It would require careful consideration of all aspects of the market and industry before drawing conclusions as to which producers meet the language of the Agreement. The only way to conduct this first step is to look at the evidence of what may or may not be directly competitive, and not foreclose the analysis by some supposed interpretation that upstream producers can never be taken to produce directly competitive products. The fact that the Appellate Body was not

[23] *Sheep & Goat Research Journal*, 2007.

[24] The AB did note: "*We can, however, envisage that in certain cases a question may arise as to whether two articles are separate products. In that event, it may be relevant to inquire into the production processes for those products*". Appellate Body Report on *US - Lamb*, para. 94.

seeking to make a definitive legal ruling that would always preclude input products is shown in its report.

Should pig producers be held not to constitute the domestic industry "producing" processed pork, the result would be to confine the relevant "domestic industry" to primary processors, many of which are (by their nature) pig producers as well.

This would not prevent an industry from being identified for the purposes of determining injury, but would effectively preclude producers (pig farmers) who are clearly suffering injury as a result of increases in imports of frozen pig meat from receiving the benefit of remedial action under the Safeguards Agreement specifically designed to address that.

Provided that processed imports and fresh pig meat can be considered to be directly competitive products, however, the domestic industry would constitute both primary processors and pig farmers as "producers" of the these products. This would not be at odds with the reasoning applied in the *US- Lamb* case.

## 4. Has the industry suffered, or is it likely to suffer, serious injury?

The pork industry has suffered severe damage in recent years as evidenced by a number of indicators.

### 4.1 Lower prices

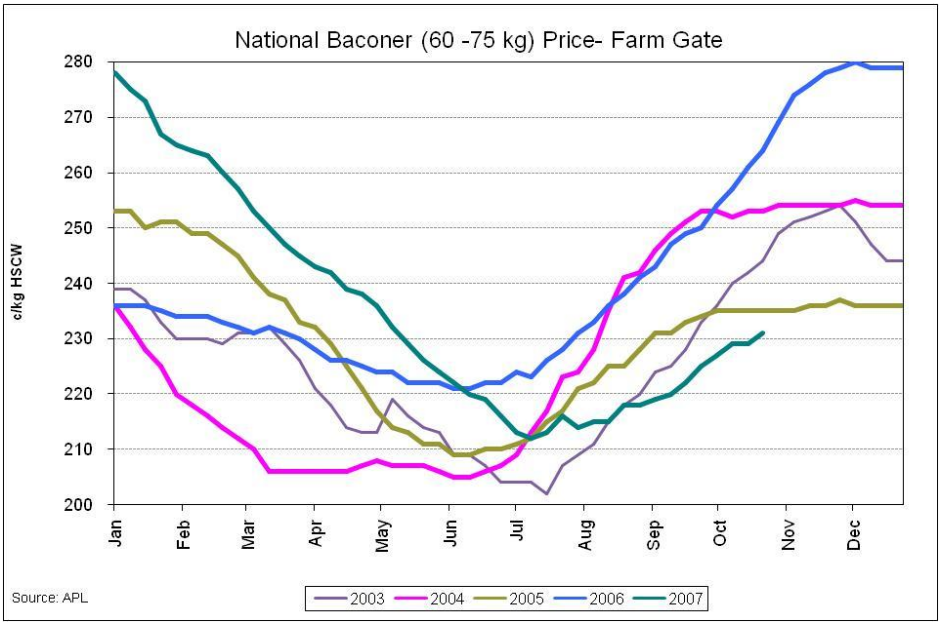
Prices for pork typically have a seasonal trend. Prices fall in the middle of the year as supply increases and then rise as demand rises and supply tightens in the run-up to Christmas. Current average pricing for baconers is $2.11 per kilogram (83 percent of total production), a 7 percent decrease compared to the same period last year ($2.28 per kilogram).

Charts 8 to 11 (below) depict the seasonal trends of pricing and suggest that although in 2006-07 pricing follows the seasonal trends, the gradient of decline is much steeper than in the past and the normal seasonal uplift in prices is at lower levels Historically high imports in the 2006-07 year have exacerbated the normal seasonal effect on prices of higher supply, and have resulted in domestic prices falling below previous years' levels.

Most recent information includes pig prices for the month of October. Comparing the first three weeks of October 2007 with the same period last year (i.e. the first three weeks in October 2006), average Eastern Seaboard baconer prices are around $2.30 and $2.60 per kilogram respectively. This equates to around a 10 percent decrease on the same period in the previous year.

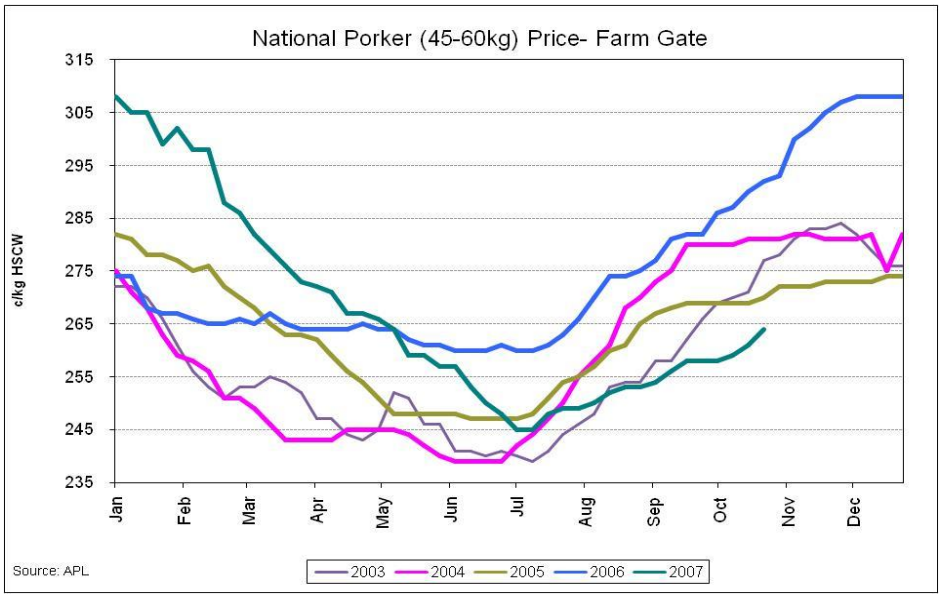
Prices are weak for primary processors as well, as the chart of boneless leg prices indicates below. Prices are not much above their lowest levels recorded over the past six years for this time of the year.

**Chart 8. National Baconer Prices (Farm Gate), 2003 – 2007**



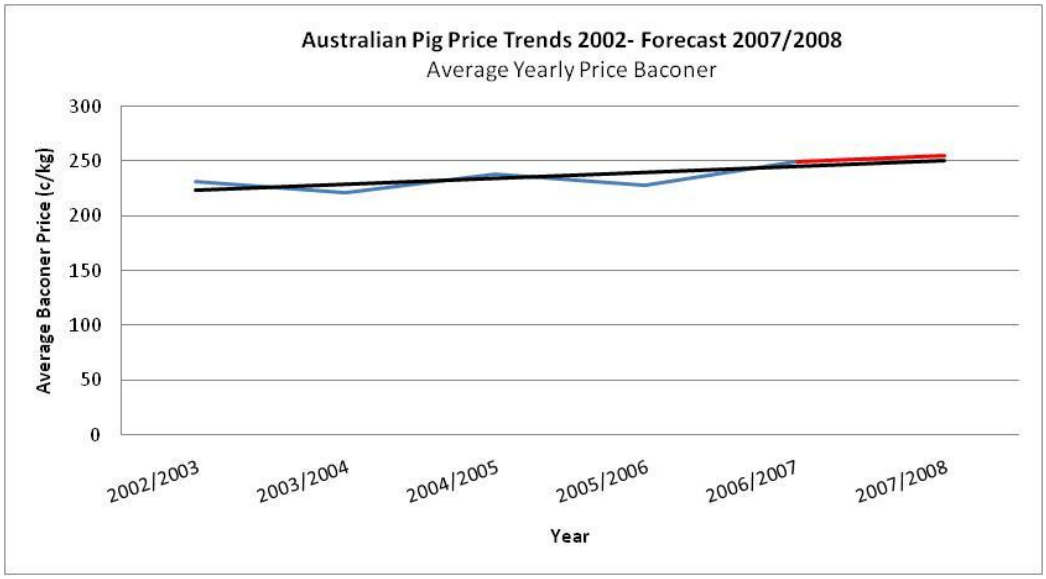

*Source: APL*

**Chart 9. National Porker Prices (Farm Gate), 2003 – 2007**



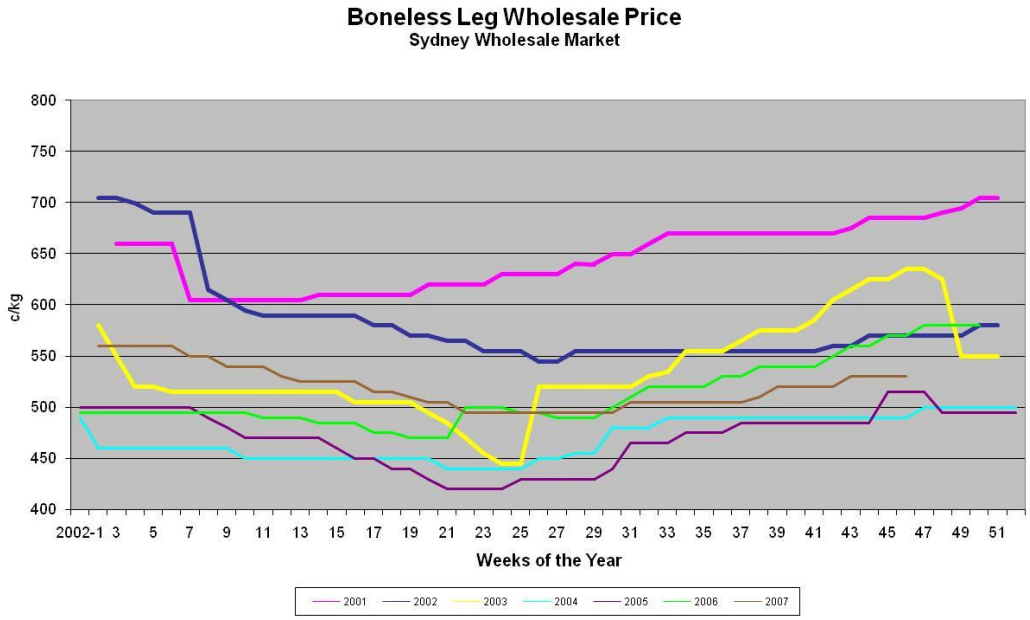

*Source: APL*

**Chart 10. Australian Baconer Price Trends 2002 – Forecast 2007/08**




*Source: APL*

**Chart 11. Boneless leg wholesale price, Sydney Wholesale Market, 2001-07**



### 4.2 Loss of income

Pork producers' income has deteriorated substantially in recent times. This cost/price squeeze facing pork producers is illustrated in Table 3 below.

**Table 3. Pig & Feed Grain Pricing, Cost of Production & Profit estimates, quarterly, 2006-2007**

| Time period | Average Baconer Pig Price[25] | Average Feed Grain Price* | Cost of Production[26] | Net Result (Profit)[27] |
|---|---|---|---|---|
| Jan 2006 Qtr | $2.37/Kg | $164/t | $2.17/Kg | $0.20/Kg |
| Jan 2007 Qtr | $2.78/Kg | $307/t | $2.61/Kg | $0.17/Kg |
| Percent Change | +17 | 88 | | |
| Oct 2006 Qtr | $2.49/Kg | $245/t | $2.44/Kg | $0.05/Kg |
| Oct 2007 Qtr | $2.19/Kg | $336/t | $2.74/kg | -$0.55/Kg |
| Percent Change | -12 | 37 | | |
| **Time period** | **Average Porker Pig Price[28]** | **Average Feed Grain Price** | **Cost of Production** | **Net Result (Profit)** |
| Oct 2006 Qtr | $275/Kg | $245/t | $2.44/Kg | $0.31/Kg |
| Oct 2007 Qtr | $2.42/Kg | $336/t | $2.74/Kg | -$0.32/Kg |
| Percent Change | -12 | 37 | | |

*Source: APL*

** Average Feed Grain Price combines the Industry average 'Best quoted grower bids' for Wheat, Barley and Sorghum*

Comparing the January 2007 Quarter with the January 2006 Quarter, producers were receiving 17 percent higher prices for baconer pigs, but paying 88 percent more for feed grain. Comparing the current period (the October 2007 Quarter) to the same time last year, producers were receiving 12 percent lower prices for pigs, but paying 37 percent more for feed grain. Even during the small window of opportunity of the peak pricing period of the January 2007 Quarter, the profit for baconer producers was estimated to have been marginal (around 17 cents per kilogram compared with 20 cents per kilogram a year earlier).

In October 2007, assuming the cost of production is approximately $2.74 per kilogram (feed grain price at $336 per tonne refer to Chart 12 below), at current pricing (October

[25] Baconer Pig price includes the Eastern Seaboard states (Vic, NSW, QLD, SA).

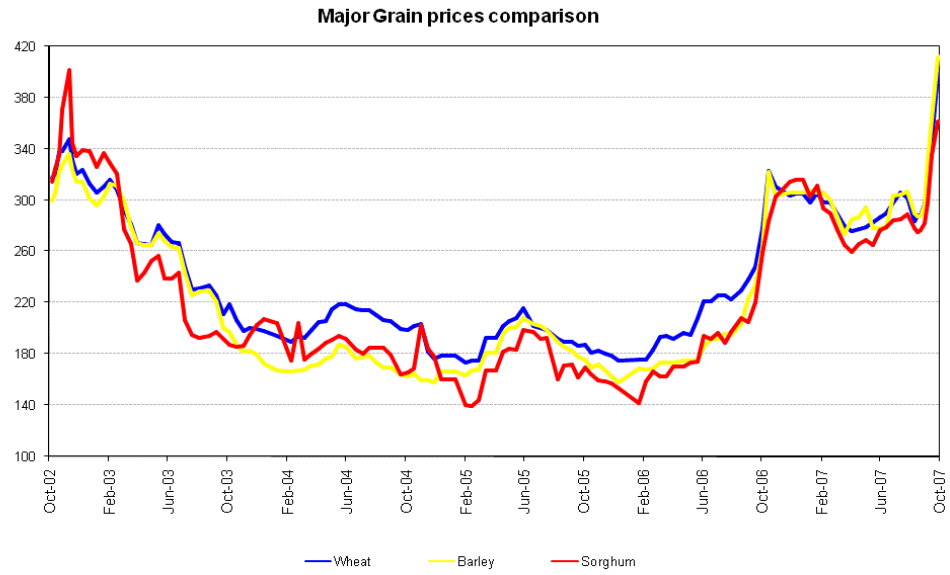
[26] It is estimated that for every $50/tonne increase in feed grain prices, will increase the Cost of Production (COP) by an average of $0.15/kg carcase weight.

[27] Assumes COP to be at $2.60/kg with grain feed prices to be $300/t.

[28] Porker Pig price includes the Eastern Seaboard states (Vic, NSW, QLD, SA).

Quarter $2.19/kg), producers are making a loss of 55 cents per kilogram. This compares with a loss of only 5 cents per kilogram a year earlier. This represents a substantial deterioration in industry profitability.

**Chart 12. Prices of major grains ($A/tonne), October 2002 – October 2007**




*Source: APL*

On a 73 kilogram pig (84 percent of total slaughter), this equates to approximately $40 per pig. Porker and baconer producers are losing 32 cents per kilo and 55 cents per kilo respectively. The estimated industry current combined (porker & baconer) loss per week is around $3.5 million per week or over $182 million a year.

Producer profitability has deteriorated very markedly in the past few months. For the Financial Year 2006-07 as a whole, on average, producers made a small profit estimated at around 7 cents per kilo (see Table 4 below). This in itself was significantly down from 2005-06 estimated profit of 20 cents per kilo.

In the final months of 2006-07, persistently low pork prices and high grain costs resulted in a sharp deterioration in profitability which has continued into the first months of 2007-08. This is indicated by the data in Table 3 (above) and 4 (below), which illustrate how grain prices have risen from an average of $279 per tonne for the year 2006-07 (Table 4) to $336 per tonne in October 2007 Quarter (Table 3), while prices for pork as a whole fell from an average $2.55 per kilogram in 2006-07 as a whole (Table 4) to $2.19 per kilogram

for baconers and $2.42 per kilo for porkers by October 2007 Quarter (Table 3). By November 2007 grain prices had risen further reaching over $420 per tonne.

**Table 4. Pig & Feed Grain Pricing, Cost of Production & Profit Financial Year estimates, 2002-2007**

| Year | Price $/kg Sold | COP $/kg | Profit/Loss $/kg | Feed Cost $/kg | Feed Cost % of COP | Av. Feed Grain Price $/tonne* |
|---|---|---|---|---|---|---|
| 2006-07 | 2.55 | 2.48 | 0.07 | 1.44 | 58 | 279 |
| 2005-06 | 2.54 | 2.34 | 0.20 | 1.25 | 53 | 178 |
| 2004-05 | 2.45 | 2.19 | 0.26 | 1.21 | 55 | 181 |
| 2003-04 | 2.20 | 2.24 | -0.04 | 1.29 | 58 | 194 |
| 2002-03 | 2.31 | 2.41 | -0.10 | 1.61 | 67 | 290 |

**$/kg is Dressed Weight (DW)**

*Average Feed Grain Price combines the Industry average 'Best quoted grower bids' for Wheat, Barley and Sorghum

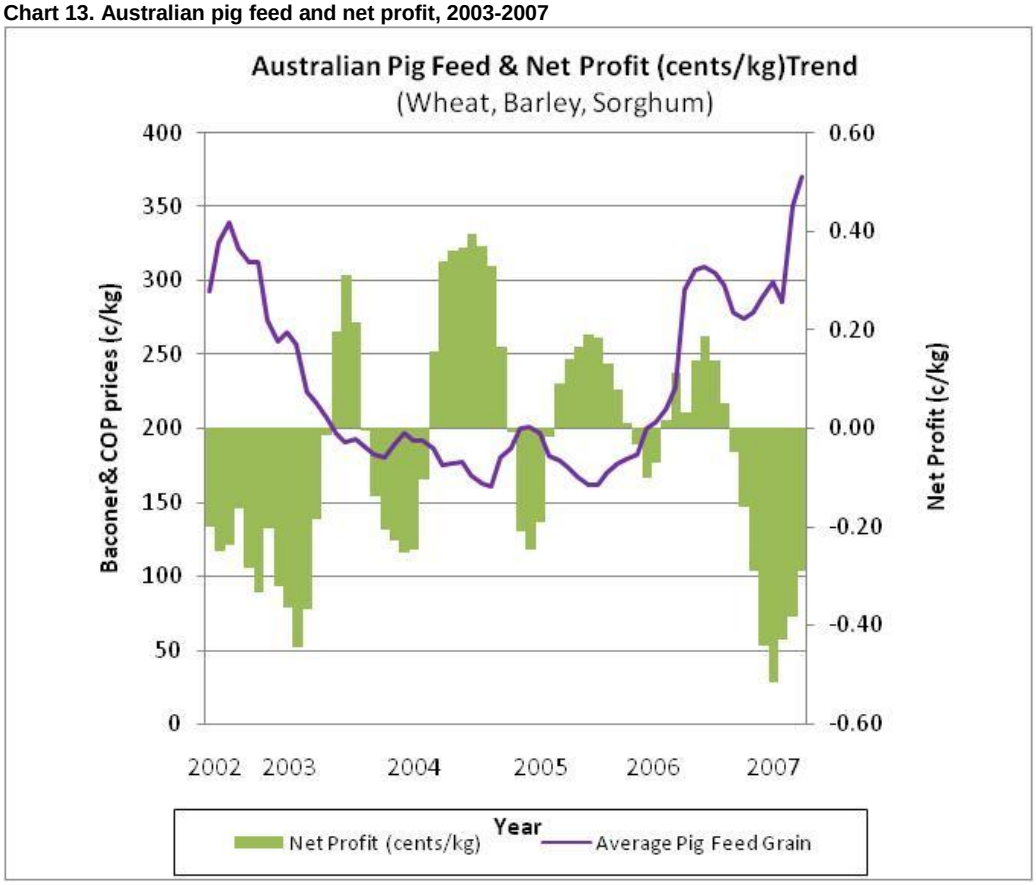
*Source data: APL Pig Stats & Profarmer*

Data that has recently become available for the September 2007 quarter further emphasises the situation. For the September Quarter (July-Sept), average feed grain price was $312/t, as opposed to the $291/t figure as above for August Quarter. For the month of September alone the average feed grain price was $361/t and as mentioned above prices in October subsequently reached $450/t.

The following Chart 13 shows how costs of production have risen well above prices, leading to substantial losses per pig produced. It demonstrates how pig prices have moved in relation to grain prices, COP increases, and net profit or losses per/kg and per baconer[29].

[29] Note: it is estimated that for every $10/tonne increase in feed grain price, cost of production (COP) will increase by an average of 0.30/kg carcase weight. This assumes: COP to be at 2.60/kg with feed grain prices to be $300/t; and COP to be at 3.00/kg with feed grain prices to be $400/t.

**Chart 13. Australian pig feed and net profit, 2003-2007**




*Source: APL Weekly Pig Pricing, APL Grain Prices/ProFarmer*

The incomes of primary processors have also been adversely affected. Information on processor profitability is generally considered confidential to the processor concerned, and may be provided by processors to the Inquiry on a confidential basis.

As an indication of primary processor profitability, however, one of Australia's largest pork producers, QAF Meats, has publicly stated its intention to substantially curtail its pork production because of drought, high grain prices and a massive increase in pork imports, closing some sites and cutting production in others. The company has reportedly made redundant 100 of its 800 workers and has indicated that further redundancies are likely.[30] A common rule of thumb used in the primary processing industry is that, for a large scale plant, every reduction in 1,000 pigs per week of throughput means a loss (at the Earnings before Interest and Tax level) of roughly $500,000 per annum owing to the reduced ability to recover fixed costs. Imports of 108,000 shipped weight tonnes in the

[30] ABC Rural News, 19 October 2007, from http://www.abc.net.au/rural/news/content/2007/s2064179htm, accessed on 19 October 2007.

current year (MAT) translate into around $14m loss on EBIT for the industry due to reduced volumes from imports in the current year alone.

According to the analysis of the gap between domestic and export prices below (see Charts 15 to 17), and based on the volumes imported in the current year of 108,000 tonnes shipped weight (MAT), the industry would receive a benefit of around $260 million in revenue if the price-gap between domestic and imported product were to be closed by a tariff. Therefore, this sum represents the injury to primary processors' revenues from imports over the period analysed.

### 4.3 Production

There has been relatively little movement in herd size and slaughtering in recent years as seen in Chart 14, with production falling by around 9 percent since 2002-03. As will be indicated below, this pattern of lower production with higher consumption can be explained by the substantial increase in imports.

**Chart 14 Pig Production Trends**


*Source: APL*

While production has remained relatively stable in the, the proportion of output that is grown for the domestic fresh pork market compared to the processed pork market has changed markedly in the last five years as shown in Table 5. In order to fully understand the impact of the changes in production and impact on producer profitability APL

undertook a survey of pork producers across Australia in November 2007[31]. This survey clearly shows the shift in pigmeat production on-farm away from processed to fresh pork:

- The current average nationwide estimate of the proportion of producer output which goes to the fresh pork market is approximately 82 percent, an increase of 5 percent in the last 12 months. This is consistent with the trend over the last five years of an increasing percentage of output going to the fresh pork market, increasing from 68 percent five years prior to the survey to 78 percent in 2006.
- The percentage of output going to the fresh pork market from medium and large producers has increased by 9 percent and 23 percent respectively from 2006. Over the last five years, small producers have increased their reliance on the fresh pork market form approximately 73 percent to 80 percent; medium sized producers from 70 percent to 87 percent and large producers from 36 percent to 71 percent.

**Table 5. Proportion of output produced for fresh pork market**

| Producer Size | Current % | 12 months ago % | 5 years ago % |
|---|---|---|---|
| **Small producers (hold less than 100 sows)** | 80.1 | 80.8 | 73.6 |
| **Medium producers (hold between 100 & 999 sows)** | 87.5 | 80.2 | 70.0 |
| **Large producers (hold greater than 1000 sows)** | 71.6 | 58.0 | 36.1 |

This should not be interpreted as indicating that the industry has suffered relatively little damage as a result of imports. On the contrary, the costs to the industry include the opportunity foregone to benefit from rises in pork consumption, driven by the industry's own paid marketing campaigns funded by levies paid by Australian pig farmers. There has been phenomenal growth in the fresh pork market domestic consumption of 35 % from 8.28 kg per capita in 2002/03 to 11.16 kg per capita in 2007as seen in Chart 7.

[31] A total of 282 producers responded to APL's Producer Impact Survey conducted in November 2007. Based on this sample size, overall national results are estimated to be accurate to within +/- 5.1% (RSE)1 for the 95% confidence interval.

## 5. Are increased imports causing serious injury?

Increases in imports have led to sustained damage to the industry. Damage has been evident in past few years in particular. It has occurred with respect to prices, incomes and production. Other factors have not caused this damage.

### 5.1 Impact of imports on prices

Imports have damaged the industry through their effects on domestic prices. The effect of imports has been to ensure prices for the domestic industry are lower than they otherwise would be. This has constrained the ability of domestic pork prices to rise when faced with higher domestic demand and/or higher costs of production.

Imports comprise three major products – frozen legs from Canada and the US, and frozen middles from Denmark.

For the purposes of this analysis, the prices of imported legs are compared with the price of wholesale prices of boneless legs in the domestic market. The NLRS Sydney Wholesale Meat Market - Pork Report price for Carton Sales Boneless Legs produced by Meat & Livestock Australia is used for the domestic price, and the import unit value of imported legs from Canada and the US are used for import prices. These prices are used for indicative purposes and may vary from actual prices received in individual commercial transactions.

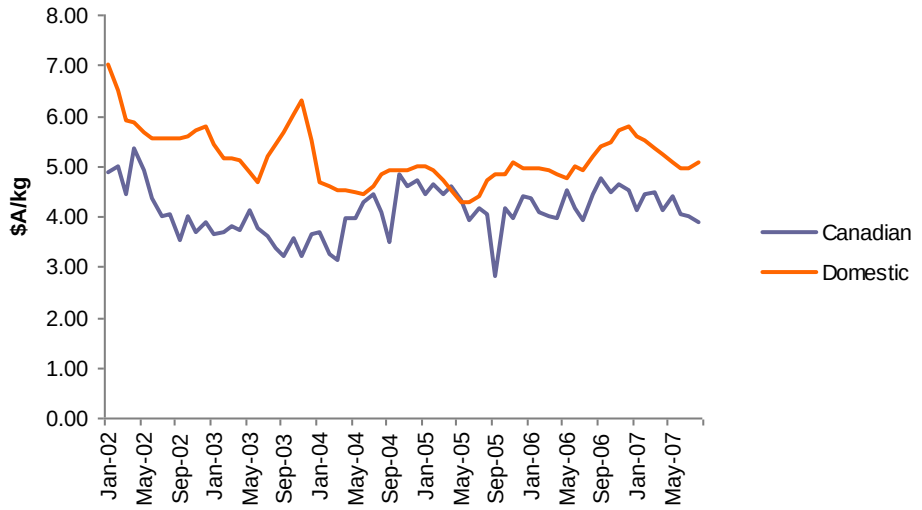
The price of imported middles from Denmark is compared with the price of wholesale middles in the domestic market. The NLRS Sydney Wholesale Meat Market - Pork Report price for Broken Sales, saddles Bone-in Middles Grade Score 2-3 is converted to a boneless equivalent using a yield of 80 percent for the domestic price and the import unit value of imported middles from Denmark is used for the import price.

The relationship between domestic and imported prices is illustrated in the charts 15, 16 and 17 below.

The clear indication from these charts is that import prices have pulled down domestic prices in almost all circumstances. Except for brief periods, import prices are below domestic prices. In period such as over the past year when domestic producers have been

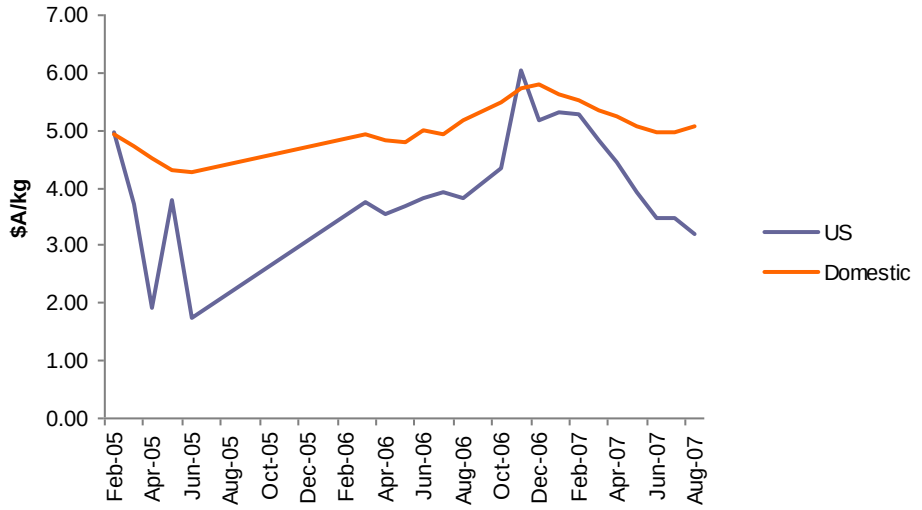
under considerable cost pressure, they have been unable to exert upward pressure on pricing owing to the constraining impact of imports. It is worth noting in the charts below and subsequent charts the sharp increase and then fall in imports in May/June 2005 for imports from all sources reflecting uncertainty in the outcome of the court case, APL v Director of Quarantine.

**Chart 15. Import unit value of Canadian legs and domestic leg price, January 2002 - August 2007**



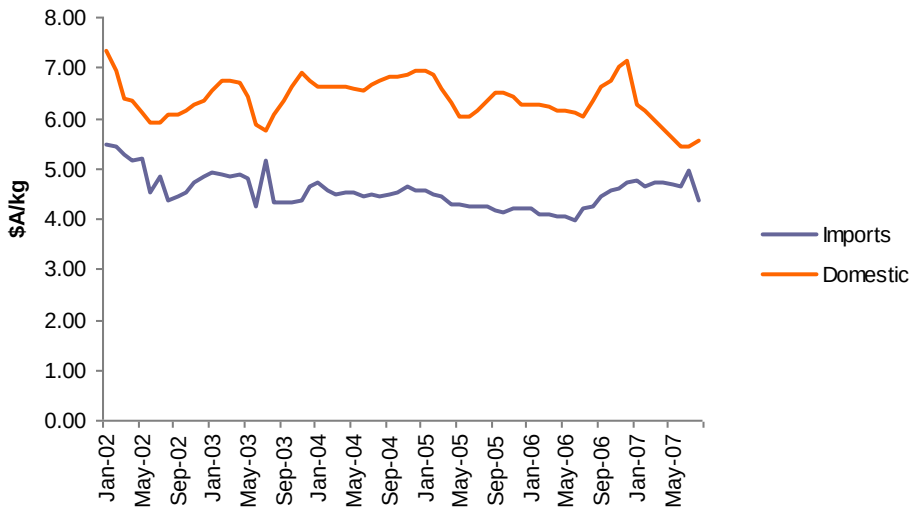

*Source: APL*

**Chart 16. Import unit value of US legs and domestic leg price, February 2005 - August 2007**




*Source: APL*

**Chart 17. Import unit value of Danish middles and domestic middles price, January 2002 – August 2007**




*Source: APL*

This link between imports and domestic prices was acknowledged by the Productivity Commission in the 1998 Safeguards Inquiry, including as verified through econometric modelling. The Productivity Commission in its report summarised the impact of imports on prices when demand increases as follows:

> In particular, with import competition, an increase in demand for hams, or other processed products which use importable pigmeat, will not translate into an increase in the domestic price of legs and pigs. If imported leg pork is highly substitutable with local leg pork, seasonal premiums for hams, for example, could be eliminated altogether. Imports thus effectively impose a price ceiling on the price of pork legs, with the height of the ceiling determined by international prices rather than local market conditions. [32]

This statement is equally valid today as reported by Mounter and Wijeweera (UNE) (Refer to Annex II). The findings from this analysis provide convincing evidence that pigmeat imports do have a substantial negative impact on domestic pig and pigmeat prices. The negative price responses hold true for the two sample periods examined, January 1995 to August 2007 and September 2002 to August 2007. The adverse impacts are more severe over the past five years, indicating that the influence of imports on domestic prices has

[32] Productivity Commission (1998) *Pig and Pigmeat Industries: Safeguard Action Against Imports*, Inquiry Report, Report No. 3, 11 November 1998, p 43.

intensified over time. The results from both sample periods display similar significant downward movements in prices. The magnitudes of the price changes are even greater when only the most recent five years data are considered.

The Commission summarised the impact of imports on pork prices when higher grain prices occur in Australia as follows:

> Any rise in pig prices due to a rise in feed or other costs of growing pigs will be moderated by the availability of imports — more of the adjustment will occur through a reduction in domestic supply than without imports. [33]

The constraining effect of imports on prices has become especially apparent in the current year. High feed grain costs have driven up the costs of producing pigs. However the ability of pork producers to pass on the higher costs is constrained by the availability of imports.

Denmark, a member of the European Union, is responsible for half of the total imports supplied into Australia and is a key competitor in export markets. However, European Union pig production is a highly distorted market. The main forms of market distortion are subsidies to European farmers, and tariffs on imports. The main types of subsidy are export refunds and private storage aid, provided under the Common Agriculture policy. These subsidies encourage over-supply of local product for export and insulate the industry from risk and competition.

Private Storage Aid is the main internal market support operating in the pork sector. When the market is weak and prices are low, private storage aids may be introduced to temporarily remove surplus supplies from the market. The effect of Private Storage Aid is to hold domestic prices up, thus insulating pork producers and maintaining production. It also provides a storage subsidy to packers and product remains available for export at the end of the storage period.

The EC's Pig Meat Management Committee decides on the rates of storage aid payable, the eligible cuts and the length of storage period to be offered. The EU support for this scheme covers both the storage costs and interest losses.

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[33] *Ibid*, p 45.

Private Storage Aid was re-introduced in December 2003, with some 85 000t having been taken off the market under this scheme. This arrangement continued until late January 2004. Depending on the length of the storage period and on the type of product concerned, the cost of the measure is estimated at around €30 m ($A49m).

Private Storage Aid is an obstacle to the entry of Australian product because it insulates the local industry from risk, and gives the local industry a degree of local price control through controlling supply.

The effect of private storage aid are felt not just in the local market, but also gives the EU a competitive advantage over Australia in export markets. The ability to control supply gives a particular advantage in Japan, a net importer of pork. Japan uses a gate price system. Pork imports priced above a set gate price pay only a 4.3 per cent tariff. However, pork imports priced below the gate price also pay a duty to the government covering the difference between the import price and the gate price. Japan has used safeguard measures to temporarily increase the gate-price and the 4.3 per cent tariff.

The European Union is able to strategically withhold product during this time. Due to Private Storage Aid, they can provide product only when the gate price is lowered.

Private Storage Aid distorts the global market for pig products as well as the local market conditions.

The Productivity Commission concluded in 1998 that imports were the dominant cause of damage, and this remains true today:

> The Commission has examined a wide range of factors which may have contributed to the injury described above and has concluded that increased imports were the dominant cause of low pig prices and reduced profitability. While production was increasing, it was only returning to pre-drought levels. The Commission is unable to find any other factor capable of explaining the large fall in demand for local pigmeat and consequent fall in pigmeat prices since October 1997. The Commission engaged consultants to try to quantify, with econometric studies, the impact of imports on the domestic industry. The results of those consultancies, and of a separate study submitted by a participant, were not decisive, but were not inconsistent with the Commission's conclusion.[34]

[34] Productivity Commission (1998) *Pig and Pigmeat Industries: Safeguard Action Against Imports*, Inquiry Report, Report No. 3, 11 November 1998, p *xxiii.*.

Two econometric studies were commissioned by the Productivity Commission in the 1998 Inquiry into safeguard action against pigmeat imports. The report by Griffith (1998) indicated there was a strong possibility that imports affect domestic prices. The IRIC/Muresk (1998) report did not find any evidence of a link from import volumes to prices. In refereeing the two reports, Dr Brett Inder identified the lack of adequate data as a key reason for this ambiguity.

The results of the econometric analysis conducted by Mounter and Wijeweera (UNE) are based on a much longer sample period than the data sets used in the 1998 studies. As shown in Annex II, this analysis finds convincing evidence of a significant causal relationship between the level of imports of pigmeat into Australia and the domestic contract bacon prices and between the level of pigmeat imports and the domestic wholesale bacon price. Increased levels of pigmeat imports are shown to have a substantial negative impact on both domestic prices.

A further factor which can contribute to lower priced imports constraining price rises in the domestic market in Australia is the level of subsidisation of production of imported products. Subsidisation reduces the risks of production and underpins profitability of producers and hence sustained supplies of pork onto world markets (including into Australia). The main sources of imports into Australia are from are the EU (mainly Denmark), Canada and the US. All of these countries support pork production with subsidies at the national and/or sub-national level.

Previous research by APL has indicated that official measures of support - notably the OECD Producer Support Estimate (PSE) - almost certainly understate the level of support given to pork producers in these countries. OECD officials acknowledge this. Support for US pig meat is likely to be at least 10 percent (i.e. 10 percent of farm gate revenue comes from government support programs) and could be as high as 22 percent if property tax concessions are included. The level of support in Canada is also likely to be higher than that indicated by the PSE of 8 percent.

Even the relatively low level of subsidies in the US and Canada compared with Denmark, (which is part of the EU where over 20 percent of farm gate revenue comes from government programs) if translated into lower prices for pig meat exported to Australia, can be associated with substantial changes in the volumes of pork imported by Australia.

There are conflicting views as to whether the support for pork producers does mean lower prices for pig meat and feed grains. It seems reasonable to conclude however that hundreds of billions of dollars of support available to feed grain and pork producers and pork processors must have some impact on production and hence prices. Such impacts could be expected to occur through: higher volumes of production than would be otherwise economic; leading to lower prices sustainable with profit for producers; and with pork producers indirectly benefiting from subsidies to grain inputs (feed grains being the target for many of the support mechanisms).

### 5.2 Impact of imports on income

Pork producers have suffered considerable losses as a result of imports. Income has deteriorated substantially in recent times. As noted above, imports have constrained pork prices from rising high enough to offset the costs of production.

Primary processors have suffered in the form of lower incomes from their pig production activities for integrated processors[35] . The number of pigs owned or contracted by the processor has reduced resulting from their loss in market share of the domestic processed pork market.

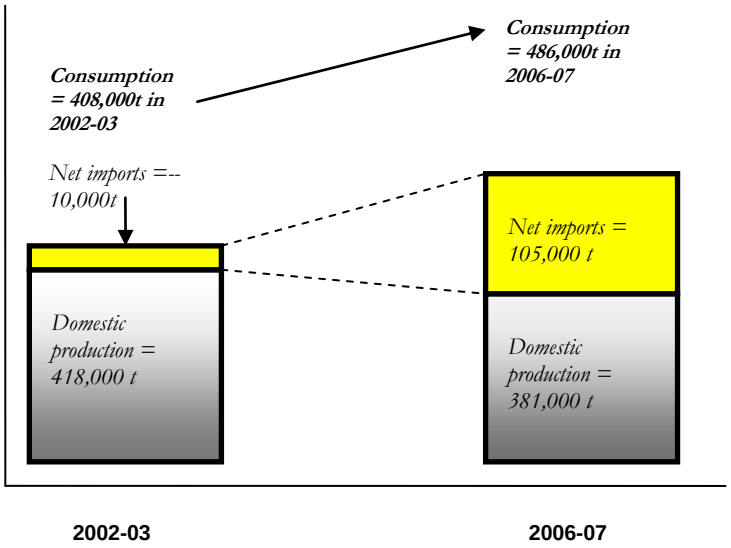
### 5.3 Impact of imports on pigmeat production

Total consumption of pork has actually risen by more than one third in recent years from around 408,000 tonnes in 2002-03 to 486,000 tonnes in 2006-07. Imports, however, have taken all of this increase, while domestic production has fallen. On top of this, nearly all of this increase has happened in the fresh pork market due to local industry promotional initiatives funded by producers; increased imports have only displaced domestic production towards domestic fresh pork consumption.

Imports' share of apparent consumption rose from negligible levels when the market was opened to around 18 percent in 2002-03. It has since risen to 34 percent in 2006-07. Import penetration has thus risen 16 percentage points in just four years. It rose 8 percentage points in the most recent year alone. The domestic pork industry has lost the opportunity, generated by increased consumption, to imports (Chart 18).

[35] As stated previously in this submission, according to industry sources around 56 percent of the pigs killed in the Australian industry are part of an integrated supply chain that includes primary processing and production.

**Chart 18. Total Australian apparent pork consumption (CWE)**




*Source: ITS Global analysis of data from APL*

APL commissioned the Western Research Institute (WRI) to estimate the economic impact of pork imports on Australian domestic pork production (refer to Annex III). The impact was measured in terms of volume of domestic production, value of domestic production as well as gross domestic product, household income and employment including flow on or multiplier effects. This analysis found that domestic pig production in aggregate would have been greater by 27.3% of the current volume of imports based on conservative supply and demand elasticities.

Therefore, the opportunity lost to the domestic industry from imports, at a weighted average price for baconers and porkers of $2.54 per kilogram is at least $114.7 million in lost production. Adopting the increase in the aggregate price of pork , which would have been 3.4 percent higher would reflect a total value of production lost of $118.6 million.

Table 6 shows the economic impact of pork imports on the pig production sector, including flow on effects, was around $324 million in output, $154 million in value added, $62 million in household income and 2,288 FTE jobs.

**Table 6. Economic Impact of Pork Imports on Pig Production 2006-07**

| Economic Indicator | Output ($m) | Value Added ($ m) | Household Income ($ m) | Employment (FTE jobs) |
|---|---|---|---|---|
| **Initial Impact** | 116.5 | 54.4 | 15.8 | 834 |
| **Flow-on Effects** | 207.0 | 99.7 | 45.8 | 1,454 |
| **Total Impact** | 323.5 | 154.1 | 61.6 | 2,288 |

### 5.4 Impact of imports on primary processing and processing sector

Table 7 shows the total economic impacts of pork imports on the Australian domestic pig production and processing, including flow on effects, were around $686 million in output, $346 million in value added, $161 million in household income and 4,971 FTE jobs.

Thus, in the absence of imports Australian pig processing and production would be 11.8% higher than it currently is with significant GRP, household income and employment impacts, many of which are concentrated in particular regional pork market.

**Table 7. Economic Impact of Pork Imports on Pig Production and Processing 2006-07**

| Economic Indicator | Output ($m) | Value Added ($ m) | Household Income ($ m) | Employment (FTE jobs) |
|---|---|---|---|---|
| **Initial Impact** | 241.6 | 122.6 | 58.1 | 1,794 |
| **Flow-on Effects** | 444.0 | 223.0 | 102.8 | 3,177 |
| **Total Impact** | 685.6 | 345.6 | 160.9 | 4,971 |

### 5.5 Other factors

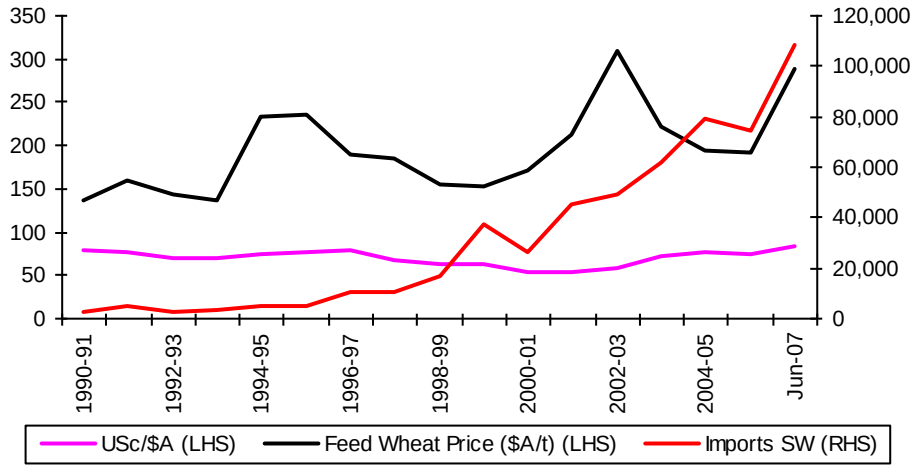
Total consumption factors besides imports may have caused injury to the industry since the market was opened, and added to the damage suffered, they do not negate the injurious effects attributable to imports.

Exports have reduced in recent years and this has may have caused injury to the industry.

The drought has increased cost of production through grain costs. **While these factors have only applied in some periods and not others, higher imports volumes have**

**been a constant factor impacting the industry throughout this time.** This is illustrated below in Chart 19.

**Chart 19. Exchange rate, feed wheat prices, and pigmeat imports, 1990 – 2007**




*Source: ABARE Australian Commodity Statistics 2006; Reserve Bank of Australia Historical Exchange Rate Statistics.*

## 5a. Are there critical circumstances where delay would cause damage which it would be difficult to repair?

The industry is faced with the imminent threat of further serious injury arising from import capture of the processed pork market within the next two years. The share of imports of the processed pork sector has steadily increased since 2002-03. It now accounts for around 64 per cent of the processed pork market (refer to Chart 6).

There is considerable urgency in applying provisional safeguards immediately and not waiting for the results of the full safeguards investigation. Both material and significant damage has already been done but most importantly it will continue to accelerate if action is not taken immediately because:

- There is substantial excess supply including inventories
- There is evidence of mounting exits from the industry. The breeding herd is being rapidly reduced and producer exits are gaining pace. Based on current trends forecasts show the industry is at real risk of overshooting a sustainable production base and the critical mass required to rebuild and regain market share will be decimated. Producers and primary processors have special purpose facilities, low land values and high exit costs; re entry to the market is in most cases unfeasible.
- Continuing cost increases cannot be passed on due to the continuing impact of imports. The magnitude and direction of these losses are escalating.
    - Producer and primary processors are cutting back employment at an increasing rate. 43 percent of producers reported in APL's Producer Impact Survey (November 2007) that they have had to reduced the working hours of part-time staff and 34 percent have reduced working hours of full-time staff. 80 percent of producers have laid off an average of 1.49 part time staff over the last 12 months and 83 percent have laid off on average of 1.91 full time staff.
    - A growing number of producers are extending their debt facilities due to loss of income in order to keep their business viable. 73 percent of producers reported in APL's Producer Impact Survey (November 2007) that they have had to extend their debt facilities in order to keep their business viable. Some 61 percent of small producers and almost all large (84 percent) and medium sized (86 percent) producers had to extend their debt facilities. (39 percent of producers - of which 43 and 42 percent

were small and medium producers respectively - had taken on off-farm work to supplement their income.)

### 5a.1 Threat of injury to pig production

Part of the industry's pig production infrastructure has been dedicated to supplying at least a proportion of the processing market. This has been decreasing with the increase in fresh pork demand, but it is still a significant proportion. The accelerated increase in imports has lead to a situation where this processed proportion of domestic production has largely no market, leading to an oversupply for the fresh market. This is depressing pig prices, well below the drought induced costs of production.

The continued drive and investment by the industry to increase fresh pork consumption reduce production costs and increase productivity will be ineffective under these kinds of volumes but critically because of the continued reduction in production. The industry will lose critical mass and will be unable to rebuild and regain market share.

Producer reactions are to reduce production, destocking, or quit the industry, and this is happening so quickly that any improvement in prices due to shortages in production will happen too late to save the production base – thus collapsing the industry. This can happen with no further increase in imports due to delays between market signals and supply shifts.

Industry data based on APL's October 2008 Interim Producer's Survey[36], a decrease of 10.69 percent by January 2008 or 14,000 sows**,** emphasizing the critical conditions confronting the industry at present. Furthermore, extrapolating this figure out would be the equivalent to 34,775 sows leaving the market place by January 2008[37]. The October

[36] APL conducts a quarterly survey of pig producers to assess change in the pig slaughter numbers or breeding herd as of the end of July. Due to the poor operating and deteriorating environment and an interim survey was undertaken. The survey covered current sows on hand and expected breeding sows at November 2007 and then again June 2008; pigs weaned and sold per litter and current farrowing and to February 2008. The results of the (regular) quarterly November survey are expected in early December.

[37] This calculation assumes, total number of sows is 306,000 and not 356,000 sows as reported in the ABS June 2006, Selected Agricultural Commodities, Australia, and excludes gilts intended for breeding (50,000). The reason for this difference is that ABS data includes gilts intended for breeding. APL data (Australian Pig Check) only counts gilts once mated. This difference in counting has an impact on herd productivity as many gilts intended for breeding do not join the herd for one reason or rather. Most overseas benchmarking program uses 'mated females' as the unit of productivity. The ABS error has been raised by APL in discussions with the Commission in October 2007.

2007 Interim Producer Survey concluded: 13 percent of producers surveyed are exiting the industry, 15% are partially de-stocking breeding herds, 4 percent are totally destocking breeding herds.

By November 2007, APL's Producer Impact Survey found that 27 percent of pork producers (with an average number of breeding sows of approximately 300) were planning to exit the industry; 32 percent of producers are currently destocking (includes partial destock 19 percent and 13 percent full destock). 62 percent of responding producers indicated that their last pigs will be sold by January to June 2008.

As already noted, the pig production industry is already losing $130 million per year. Projections under approaching cost and price scenarios point to pig producers losing up to $5 million per week over the next year (or $260 million per year) if present trading conditions persist, almost doubling the current estimates of $2.6 million per week.

Market information and data shows that the injury to the industry in terms of lower profitability, reduced employment and/or exiting pig farming is being born across the industry from smaller family farms to larger producers and large commercial operations such as QAF. Furthermore, as producers continue to suffer losses and exit the industry, little to no industry reinvestment (producers go to "hand to mouth") occurs and ongoing maintenance of infrastructure suffers. Under the existing conditions, producers struggle to realise true asset values. This is complicated further as infrastructure is not transferable across industries. (It is deemed by banks as "special securities" since if it is not in use it cannot be used for other farming practices.) Also the asset value of infrastructure has no real use by date, if maintained, and will continue to be functional. However as producers' go "hand to mouth" their ability to maintain this infrastructure is compromised raising another set of significant issues concerning OH&S responsibilities to their employees and also the animal welfare conditions of the pigs.

There is a real risk in particular that producers will "overshoot' in terms of not replacing breeding stock given the industry outlook, and this will lead to the collapse of the industry. It should be noted here that it takes approximately 19 months from full destock to full capacity with mating of sows, etc.

If this is avoided, then the longer term outlook for the industry remains at risk. In relation to pig production, as facilities get older without the ability to reinvest in up-to-date

technology, the global competitiveness of the production sector will continue to decline. It will also discourage further external and internal investment in the industry. Most small producers are losing money and returns on assets are negative. A major producer is in receivership. Inadequate returns and continuing import penetration are leading to investment being withheld. The longer term competitiveness of the industry is thus being undermined.

Any producer who had borrowed money to invest in this industry over the past five years would have failed to improve their equity position to any degree. This has in turn totally discouraged further investment in the industry by those companies who have shown a tendency in the past to invest in pig production. As facilities get older, without the ability to reinvest in up to date technology, the global competitiveness of the production sector will continue to decline.

**5a.2 Threat of injury to primary processors: abattoir and boning rooms**

Continuation of current import trends will result in further injury to the primary processing sector. In the short term the profitability of the primary processing sector may benefit from the continued high level of imports and the resulting oversupply of pigs in the domestic fresh market market ( as producers quit the industry and/or sell off their breeding stock), suppressing domestic prices. This will especially be the case in relation to exports, where the Australian industry has secured a premium priced market for chilled pork into Singapore.)

However, in the longer term pig producers will not be able to maintain production of pigs in a market of prices below production costs, and the volumes supplied for abattoir, boning rooms, processing, and even into the premium export markets, will decline. Without doubt the competitiveness of abattoirs and boning rooms will decline and their costs will rise as capacity utilisation falls; and processing costs will rise until processing capacity is reduced to match the reduced volume of throughput. This will result in heavy job losses in pig production, slaughtering and boning in regional and rural Australia.

Whilst quarantine restrictions on imports of bone-in products are maintained, there will be a requirement for some level of domestic processing capacity aimed at the domestic processed products market. However one can envisage that this may entail a domestic

processing sector accounting for no more than 15 percent of total processed product demand.

This requirement, together with the requirement for slaughtering and boning of fresh product, will constitute the total market for Australian pork. Pig producers and abattoirs and boning rooms will have to downsize accordingly to the point where they can operate profitably at these lower levels of production. The industry will be highly exposed to price movements in the fresh market, which will dominate demand.

It should be noted that with respect to both pig production and slaughtering and boning, there are considerable sunk costs. The industry is highly capital intensive and volume dependant. This differentiates the pork industry from many other agricultural industries.Strategies and investments to reduce costs of production and/or increase productivity will be abandoned due to the lack of investment capital, thus embarking the industry on a vicious circle. The costs of production are largely of a fixed nature, and this together with the low value of land tied up in pig production and slaughtering and boning rooms (with most facilities located away from urban areas for reasons of environmental regulations) mean that the costs of exiting the industry are high.

Once productive capacity is lost it will not be a simple matter of resources moving back into the industry in a seamless fashion at some point in the future in response to returns. The cost of restocking piggeries has a significant capital and cash flow impost to farmers. Mothballing and then recommissioning processing facilities is also costly. Finding qualified labour is also a significant challenge.

**5a.3 Critical circumstances**

The preceding analysis shows the industry is at a critical juncture. It is not possible to predict accurately how economic factors turn in the future. It is possible however to assess the risk of change. The risk is significant that immediately recent import trends of rapidly increasing imports of middles and legs (i.e. over the last two years) could continue at same or similar rates, resulting in the complete capture by imports of the processing industry.

The preceding analysis describes how this will create an unviable set of circumstances for the industry which could result in irreversible change given the highly capitalized nature of the industry.

These are critical circumstances which warrant immediate imposition of provisional safeguards to avert damage which could not be reversed.

# 6. What safeguard measures would remedy serious injury?

### 6.1 Accurately reflecting the terms of the WTO Safeguards Agreement

Question 6 does not accurately reflect the conditions which need to be satisfied to impose a safeguard. They also differ between routine safeguards and provisional safeguards.

Article 5.1 of the Agreement states the aim of the Agreement is to allow imposition of safeguard measures only to the extent necessary "to prevent or remedy serious injury and to facilitate adjustment". Measures must both prevent or remedy serious injury and facilitate adjustment.

Article 6 of the Agreement states provisional safeguards can be applied "In critical circumstances where delay would cause damage which it would be difficult to repair". Before imposing the measure, a preliminary determination that there is clear evidence that increased imports have caused or are threatening to cause serious injury is necessary.

### 6.2 Assessment of possible measures

This analysis identifies options for measures, specifically - border measures that would assist the industry in overcoming the current injury it is facing and to adjust. The focus of the analysis is on impacts on the domestic pig industry, rather than the broader economy. Assessing the economic impacts on the broader economy would entail a much broader, national level analysis than is allowed for here.

However, given the Commission is required to report on whether having regard to the Government's requirements for assessing the impact of regulation which affects business, safeguard measures that would prevent or remedy serious injury should be implemented, a discussion of regulatory impacts is contained in Section 7.

The analysis in this submission is based on the assumption that all assistance measures are possible, unless they conflict with Australia's obligations under the WTO or other binding international agreements. In terms of measures that can be considered as safeguard measures, (the major focus of the industry's submission for consideration by the Productivity Commission), the following table sets out the requirements for safeguards measures.

**Table 8. Summary of WTO requirements for the imposition of safeguard measures**

| Scope of requirement | Requirement |
|---|---|
| ***Type of measure applied*** | For full safeguard measures, the type of measure to be applied is not specified, however it is clear that such measures must be the "suspension or withdrawal of concessions made under the GATT." Tariffs and quantitative restrictions clearly fall into this category and are expressly mentioned.<br><br>For provisional safeguard measures, the Safeguards Agreement stipulates that tariff measures be applied. |
| ***Level and extent of measure applied*** | There is generally no prescribed level for safeguard measures applied under the Safeguards Agreement however they must be commensurate with remedying injury and facilitating adjustment. There is no requirement to demonstrate this or to consider adjustment plans before the measure is adopted, however it would be required should the measure be challenged by a WTO member.<br><br>Where quantitative restrictions are applied which reduce imports the level of a "recent period", however, a "clear justification" is required at the time the measure is applied to explain how and why the measure was necessary to remedy serious injury and facilitate adjustment of the domestic industry. A "recent period" is defined in the Agreement as "the average of imports in the last three representative years for which statistics are available". |
| ***Scope of application*** | Measures must be applied to a product being imported "irrespective of its source". This requires that measures be applied to the imports in question from all sources. They could not be restricted to imports from one or only several countries. |
| ***Duration of the measure*** | Full safeguard measures must be applied "only for the period of time necessary to prevent or remedy serious injury and to facilitate adjustment." This must not exceed a four year period. It includes the duration of the application of any provisional safeguards. The application of provisional safeguards must not to exceed 200 days. Measures can be extended beyond this, however the total period of application must not exceed 8 years.<br><br>Where measures are to apply for over one year, they must be progressively liberalized at regular intervals whilst applied. |
| ***Application to products previously subject to safeguard measures*** | There are some restrictions on measures applied to products which have been subject to measures in the past, although there are some options to reapply safeguard measures in certain circumstances. |
| ***Other obligations - maintenance of concessions*** | Members are obliged to "endeavour to maintain" equivalent concessions with exporting members affected by safeguard measures. As a first step, this requires providing an adequate opportunity for prior consultations with affected members on the proposed measures. |

*Source: WTO Safeguards Agreement and WTO disputes cases*

### 6.3 Options for measures for the industry

There are a number of measures which could be applied to assist the pig meat industry in dealing with its current condition. For this analysis they have been characterised as border measures and non-border measures i.e. payments/incentives (commonly referred to as subsidies). Such measures should address each of the major adverse conditions facing the industry outlined above (viz. adverse impacts on prices, incomes and production) as well as facilitate restructuring.

For the purpose of this analysis however, APL is restricting its comment to border measures. So serious is the injury facing the industry that unless immediately addressed the consequent damage would be severe and lasting: only a provisional safeguard will provide the necessary immediate breathing space required by the industry to arrest further damage to it. . Other complimentary measures at this critical point would be redundant in their effectiveness if undertaken in isolation without a provisional safeguard. APL will provide further detail on other proposed non-border measures in it subsequent submission.

#### 6.3.1 Border measures

Border measures impact on the international trade of the industry through controls on trade flows at the border. The imports causing injury to the industry are frozen legs from Canada and the USA and middles from Denmark. Trade measures would be applied against such products. It should be noted that under Article 2 of the Safeguards Agreement, safeguard measures shall be applied to a product irrespective of its source, so trade measures would need to be applied to imports of frozen legs and middles from all sources.

A number of different border measures exist, the main ones being tariffs and quotas. A combination of the two measures is a tariff rate quota (TRQ).

Impacts by industry condition

The impacts of broader measures can be analysed in terms of their contribution to addressing the adverse conditions facing the industry. See Table 9 below.

**Table 9. The impact of border measures on industry conditions**

| Condition | Impact of border measures |
|---|---|
| ***Depressed prices*** | Prices should increase unless there is absorption of tariffs by importers; stronger certainty of price increases by means of quotas than tariffs. |
| ***Profitability*** | Profitability should increase depending on extent of higher prices, costs remaining unchanged. |
| ***Competitiveness*** | Selling prices in domestic market rise; the attractiveness of exporting is reduced; inefficiency can be introduced through resource misallocation in the firm. In the longer term competitiveness can be improved through scale efficiency; investment certainty can be increased. |
| ***Restructuring*** | Can assist restructuring by stabilizing and encouraging investment; then being progressively liberalised according to a timetable, increasing competitive pressure for rationalisation. |

*Source: ITS Global analysis*

Tariffs and quotas both serve to raise the price of the imported product higher than would otherwise be the case. However trade can still occur under tariffs, with an increase in demand for the product resulting in higher volumes of the product being imported. The extent to which price increases generated by the tariff are absorbed by importers will determine how much extra consumers actually pay, and hence the impact on their demand.

Quotas restrict the imports absolutely to the amount specified. Increases in demand cannot be accommodated. Quotas are thus more certain in their impact on the domestic import competing industry than tariffs.

In the case of tariffs, the Government receives the revenue generated from the tariff. However the distribution of the revenue generated by quotas depends on how the quotas are allocated to importers. If quotas are allocated to importers by Government administrative mechanisms (e.g. based on historical shares of imports) it will mean the quota "rents" are given to those receiving the quota.

If the quotas are sold by the industry to the highest bidder on an auction basis, the rents will be competed away and the seller of the rights receives the revenue. In theory the Australian pigmeat industry could allocate the quotas and receive the revenue, but Governments generally wish to keep control over rent receival.

An immediate, potential use of border measures for the industry is their use as provisional safeguards.

Provisional safeguards

Provisional safeguards in the form of tariffs which provide immediate respite from the injury caused and threatened by imports could certainly be applied. The level of such tariffs should be such as to immediately restrict trade. It should be determined by reference to the level of prices experienced over an appropriate period relative to the prices paid for a like competing domestic product.

For the purposes of this analysis, we have identified the difference in price over time between the imported products and the price of similar products in the domestic Australian market. This difference, or "price gap", gives an indication of how much cheaper or more expensive the imported product is compared to the domestic product.

Of course, to some extent, the imported product's price influences the price of the domestic product, given the degree of penetration by imports in the domestic market. This analysis assumes that the imported and domestic products are essentially substitutes for each other. It also gives an indication of the competitiveness of imports in the domestic market.

If the price of the imported product is cheaper than the domestic product, then the price gap gives an indication of how big a tariff would need to be applied to imports in order to raise the imported product price to make it equal to the price prevailing in the domestic market as a whole.

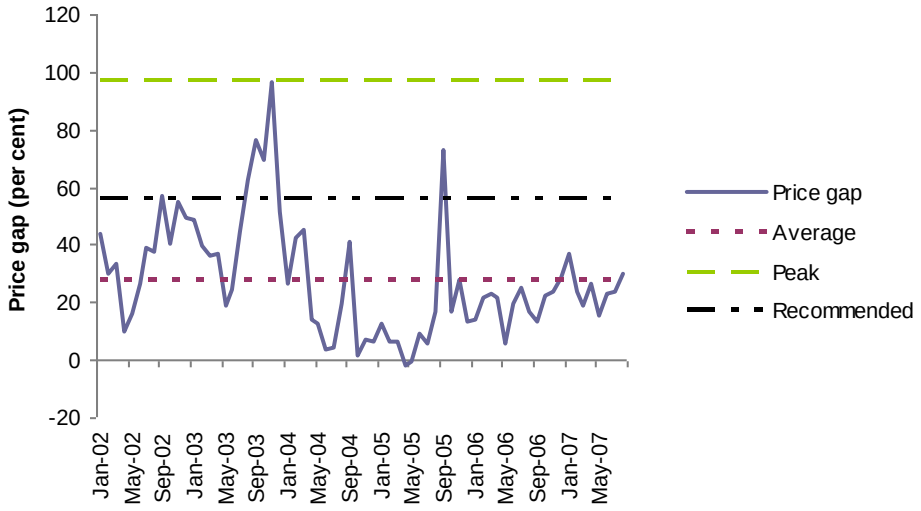
In the analysis undertaken, the difference between the imported price and the domestic price is measured. This is the "price gap" required to make them equal. For the period since January 2002 for Canadian legs and Danish middles, and since February 2005 when imports of legs from the US commenced, this gap is illustrated in the charts below.

Price gap for Canadian products

Chart 20 below shows the gap in the price between the imported Canadian and domestic market legs on a monthly basis since January 2002 (indicated by "price gap"). The imported product has varied between being roughly equal to and nearly 100 percent cheaper than the domestic market price over this period. The average gap has been around 28 percent (indicated by "average" in the chart); hence it would take a tariff of this

amount to raise the average price of imported product sufficiently to equal that prevailing in the domestic market over that time.

**Chart 20. Canadian legs import price gap, January 2002 – August 2007**




*Source: ITS Global analysis of data from APL*

It is evident that the gap increases substantially during certain periods of the year, notably towards the end of the year when the imported price is substantially below the domestic price. Viewed another way, this is the period when any tariff or other measure to raise the cost of the imported product based on the price gap in the charts would need to be much higher. Not surprisingly, this is also the period of the year when imports tend to increase. Clearly if a tariff measure were to be applied based on the average price gap over the period examined, for critical parts of the year it is clear that the measure would not effectively restrict imports since it would not offset the very low price levels of imported product. Thus the measure would need to be based on a higher level of price gap.

The highest peak of the gap experienced over the years examined could serve for such a measure. However, imposition of a tariff equal to the previous years' peak would most likely prevent trade altogether. This level is indicated as the "peak" in Chart 20 for Canadian legs. The highest level of this peak for legs occurred in November 2003 and amounted to nearly 100 percent.

However, totally preventing trade, even for the provisional safeguards, would adversely affect the industry given the high degree of import penetration currently. Instead, it may

be preferable that the initial measure cover the average level of the peak gap experienced over the years examined. The average peak price gap which has occurred in each of the years shown for legs is around 56 percent – this is shown as the "recommended" level in Chart 20. It would take a tariff of this level to ensure the price of imported product was equal to the domestic market price during periods of the lowest prices for imported product relative to domestic market prices on average over the period examined.

Price gap for US products

A similar analysis has been done on the price gap between imported legs from the US and domestic legs.

Chart 21 below shows the gap in the price between the imported US and domestic market legs on a monthly basis since February 2005 (indicated by the price gap). The imported product has varied between being roughly equal to and 145 percent cheaper than the domestic market price over this period. The average gap has been around 36 percent (indicated by "average"); hence it would take a tariff of this amount to raise the average price of imported product sufficiently to equal that prevailing in the domestic market over that time.

Similarly to the situation with Canadian legs, if a tariff measure were to be applied based on the average price gap over the period examined, for critical parts of the year it is clear that the measure would not effectively restrict imports since it would not offset the very low price levels of imported product. Thus the measure would need to be based on a higher level of price gap.

The highest peak of the gap experienced over the years examined is indicated as the "peak" in Charts 21 for US legs below. The highest level of this peak for US legs occurred in June 2005 and amounted to nearly 145 percent.

However, imposition of a tariff at this peak level would totally prevent trade, and it may be preferable that the initial measure cover the average level of the peak gap experienced over the years examined. The average peak price gap which has occurred in each of the years shown for US legs is around 80 percent – this is shown as the 'recommended" level in Chart 21. It would take a tariff of this level to ensure the price of imported product was equal to the domestic market price during periods of the lowest prices for imported product relative to domestic market prices on average over the period examined.

Legs are imported from both Canada and the US, and based on the price gaps the recommended tariff for legs from the US is 80 percent compared with 56 percent for Canadian legs. Since any measures must be applied to a product being imported "irrespective of its source", a weighted average tariff can be calculated based on the volumes of imports supplied by the US and Canada respectively. Over the period examined, Canada has accounted for around 86 percent of the total imports of legs and the US has accounted for around 14 percent. Weighting the tariffs of 56 and 80 percent respectively by the volume supplied, a weighted average tariff for legs would be around 60 percent.

**Chart 21. US legs import price gap, February 2005 – August 2007**


*Source: ITS Global analysis of data from APL*

Price gap for Danish products

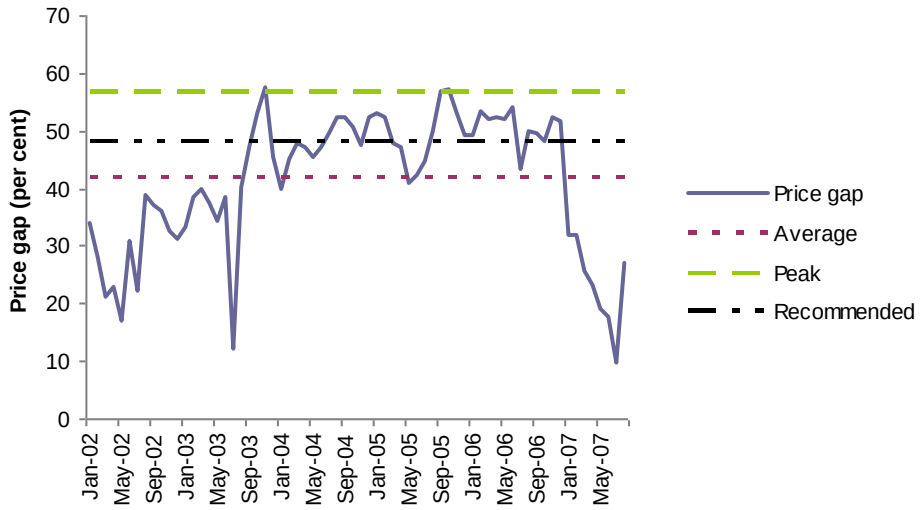
A similar analysis has been done on the price gap between imported middles from Denmark and domestic middles, and this is shown in Chart 22. In this case, the average price gap and hence tariff required is around 42 percent (indicated by "average"). The highest peak over the period analysed was around 57 percent (indicated by "peak"), and a tariff at this level could be expected to prevent trade altogether. The average seasonal peak over the period analysed is 48 percent (the "recommended" level).

On the basis of this analysis, it is recommended that a provisional safeguard measure be applied with a tariff on imported legs of 62 percent (the weighted average of the seasonal peak price gaps) and imported middles of 48 percent. These are derived from the average seasonal peak levels of the price gaps for these products over the period analysed. They

would not prevent trade altogether, and would provide sufficient impact to reduce the price competitiveness of the imported product. Discussions with industry sources have confirmed that the unit values and prices used in the above analysis do reflect commercial data, and that tariffs based on the above analysis would mean prices at levels that would enable a breakeven under normal market conditions.

The potential use of border measures for the pigmeat industry is also discussed below with respect to full safeguards.

**Chart 22. Danish middles import price gap, January 2002 – August 2007**




*Source: ITS Global analysis of data from APL*

Full safeguard measures

Unlike in the case of provisional safeguards, where the measure applied should be a tariff, other measures can be used in the case of full safeguards.

There are a number of options for measures in the case of full safeguards, namely:

- Quotas
- Tariff rate quotas
- Subsidies

Each will be addressed in turn.

Quota measures

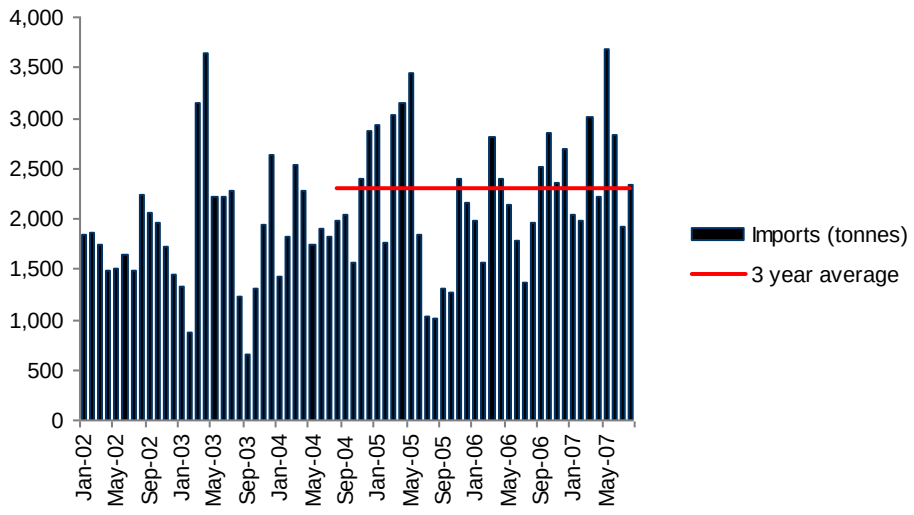
As mentioned previously, a quota provides a higher level of certainty in restricting imports than a tariff. The abovementioned tariff measure for provisional safeguards would not provide the certainty provided by a quota.

The Safeguard Agreement's requirements regarding quotas are that where quantitative restrictions are applied which reduce imports the level of a "recent period", that "recent period" is defined in the Agreement as "the average of imports in the last three representative years for which statistics are available".

So for full safeguards the measure applied could be a quota based on the average of the past three years imports of legs and middles. For legs, based on Canadian imports over the past three years the quota for legs could be set at 2,295 tonnes per month (see Chart 23 below) , and based on US imports since they began entering the country the quota should be set at 1,486 tonnes per month (Chart 24 below). A weighted average of the two quotas is 2,092 tonnes.

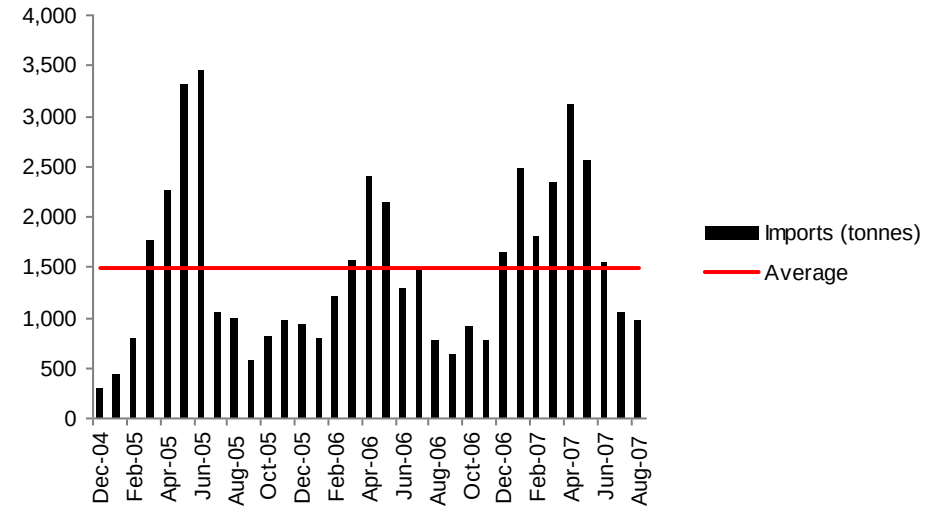
A quota for middles based on Danish imports over the past three years could be set at 2080 tonnes per month (Chart 25 below).

**Chart 23. Canadian leg imports, January 2002 – August 2007**



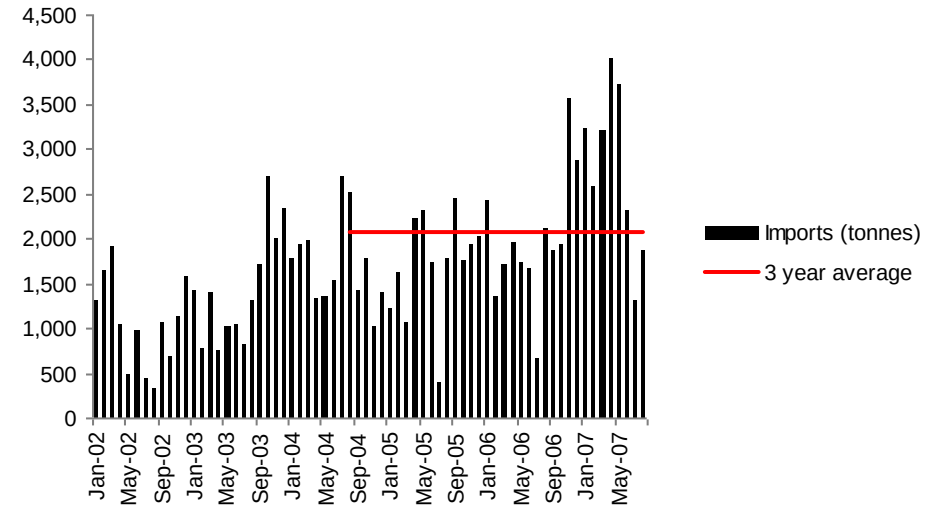

*Source: ITS Global analysis of data from APL*

**Chart 24. Leg imports from US, December 2004 – August 2007**




*Source: ITS Global analysis of data from APL*

**Chart 25. Middle imports from Denmark, January 2002 – August 2007.**




*Source: ITS Global Analysis of data from APL*

Tariff rate quota (TRQ) measure

Tariff rate quota combines a quota with a tariff applied at any imports above the quota level. Whereas a quota totally prevents imports above a certain level, a TRQ allows imports above the quota level but on condition of payment of the tariff.

A TRQ becomes relevant in that the average level of imported tonnage is significantly below the level of imports that has occurred in recent times for products from Canada, the US and Denmark. Imposition of a quota at the three year average level of imports could thus be expected to significantly restrict trade in certain months if the level of imports in recent times were to be maintained or increased.

For this reason, a TRQ could provide both certainty for the industry that the injury caused by imports will be addressed by the trade measure and allow trade to proceed at levels of imports over and above the quota level.

One option is for the quota to be set at the three year average level for legs (weighted average for US and Canada, i.e. 2,092 tonnes per month), and for middles 2,080 tonnes per month, augmented by the tariff identified for the provisional measure i.e. a tariff on imported legs of 62 percent (the weighted average of the seasonal peak price gaps) and imported middles of 48 percent.

The above quota tariff will begin at that of the provisional measure and should stay at this level for a further six months (i.e. beyond the 200 day expiry of provisional safeguards – taking the industry period of safeguards measures to one year).

The requirement that safeguards support adjustment in the industry could be met by the following measures:

- Phasing out the trade measures over an appropriate period. The tariffs should be reduced to the average level of tariff indicated above (producing a weighted average of 30 percent for legs from Canada and the US, and an average for middles from Denmark of 42 percent) at the end of two years, and eliminated at the end of three years. The quotas for legs and middles should then be eliminated at the end of four years. This timetable will provide a deadline for the industry participants to determine whether they wish to stay in the industry on a long term basis.

- Using non-border measures as incentives for adjustment. These are mentioned briefly below. At this stage it should be noted that such measures could also ensure any adverse impacts on the competitiveness of the industry flowing from border measures are minimized.

An important disadvantage of quotas as a measure is the difficulties, and potentially the administrative costs, associated with allocation of quotas. This suggests that it may be a preferable option for the tariff applied for provisional safeguards to be extended on a diminishing level until elimination after 4 years.

Impact of measures on industry revenues

Assuming imports at current levels of around 108,000 tonnes, and an average tariff (across both legs and middles) of around 57 percent (70 percent of total imports being legs from the US and Canada at a tariff rate of 62 percent and 30 percent of total imports being middles from Denmark at a tariff rate of 48 percent), and average import values of $4.30 per kg, the tariffs should serve to increase prices to the industry by up to $260m. This is before any subsequent impacts on demand and supply are measured.

6.3.2 Non- Border Measures: Payments and incentives

Apart from tariffs and quotas, a number of other support measures which impact on the industry but are not applied at the border could be considered. The main measures of this kind are payments to or incentives for producers or processors. It should be noted that these measures tend to have a medium term to long term impact in contrast to the tariff measure recommended for provisional and full safeguards which has an immediate impact.

These measures can take many different forms. They can include assistance for investment, research and development, production, training, relocation, and others. The best means of characterizing these measures is by the purpose they serve

- Payments to enhance exports;
- Payments to increase production capacity;
- Payments to increase industry adjustment;
- Payments to support incomes.

Payments with the above purposes also take different forms, such as grants, tax concessions, income or price support, loan guarantees and many others.

Due to the accelerated timeline of the first report and to enable APL to provide substantive information and analysis to support our proposals, APL will elaborate on suitable non-border measures, including but not limited to those characterised above in APL's next submission to the Commission.

### 6.4 Action by the Productivity Commission

APL submits that the most immediate and effective government measure to be taken to facilitate adjustment is provisional safeguards followed by full safeguard import controls as proposed in this submission. This will give the industry breathing space to restructure in an orderly way.

APL submits there is a requirement for provisional safeguards with:

- tariff of 62 percent for legs
- tariff of 48 percent for middles

This should apply for 200 days, following which full safeguards should apply at the above rates, phasing down to the end of the four year period.

Knowledge that the measures are to be phased out within four years will create incentives for the industry to select its preferred form of restructuring.

Subsidies are sought to assist that transition. Consideration should be given to support measures in the form of payments to producers and processors for adjustment to regulatory requirements and to assist repositioning of the industry against import competition.

The above action will safeguard the critical mass of the industry, which must be maintained if the industry is to recover from the damage being caused by imports and likely to be caused. The process of adjustment will be much more efficient and the negative impact on welfare minimized if industry is given time to manage its own process of restructuring.

## 7. What are the impacts on other parties?

### 7.1 Justification vs. application

It is important to distinguish between the questions of whether safeguard action is legally justified (whether safeguards *can* be applied) and whether it is the best policy option to facilitate adjustment in the industry (whether they *should* be applied). In accordance with the terms of reference of the Inquiry, both are to be addressed by the PC in some way. The former is to be answered by the PC by applying the legal criteria under the WTO Agreement on Safeguards. [38] The latter is an assessment to be made by evaluating the impact of regulations which affect business.[39]

### 7.2 Whether or not measures are legally justified

There is no requirement under WTO rules for the PC to consider whether safeguards are the best policy option, or whether safeguards are in the public interest, in determining whether they are legally justified. In its Issues Paper, the PC quite rightly points out that the Agreement stipulates that "interested parties" (other than the domestic industry) must be given an opportunity to present their views, including as to whether the imposition of the safeguard measures would be in the public interest. [40] This is also a requirement under Australia's procedures for the conduct of the Inquiry, notified to the WTO.[41] However, this does not require the Commission to assess the impact of safeguard measures on

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[38] Under the terms of reference to the Inquiry the PC must 'report on whether the conditions are such that safeguard measures would be justified under the WTO Agreement.'

[39] According to the terms of reference of the Inquiry and pursuant to the Act under which it operates. This is consistent with the general procedures established for Inquiries by the PC as set out in the *Commonwealth of Australia Gazette No S 297, 25 June 1998* as notified to the WTO.

[40] Article 3 of the Safeguards Agreement states 'This investigation shall include reasonable public notice to all interested parties and public hearings or other appropriate means in which importers, exporters and other interested parties could present evidence and their views, including the opportunity to respond to the presentations of other parties and to submit their views, *inter alia*, as to whether or not the application of a safeguard measure would be in the public interest…'.

[41] The procedures mandate that that the inquiry 'involve[s] public hearings or other appropriate means in which importers, exporters and other interested parties can present evidence and their views, including the opportunities to respond to the presentation of other parties and to submit their view …as to whether or not the application of safeguard measures would be in the public interest'. See *Commonwealth of Australia Gazette No S 297, 25 June 1998*, article 7.

interested parties, or to assess whether the measure is in the public interest in determining whether the legal requirements for imposition of measures have been met.

The factors that must be considered, for example in deeming whether imports are causing injury, are clearly set out in Article 4.2 of the Safeguards Agreement. Article 3 of the Agreement (and paragraph 7 of the gazetted procedures) require the PC to reach "reasoned conclusions" on all "pertinent issues of fact and law"[42] when it is conducting its investigation into whether the requirements in Article 4 have been met. In the 1998 safeguards inquiry, the PC reaffirmed this and found that measures were justified. [43]

### 7.3 Whether or not safeguard measures should be applied

Under the terms of reference of the inquiry, and pursuant to Australia's procedures for undertaking inquiries for the imposition of safeguard, the PC is required to report on 'whether, having regard to the Government's requirements for assessing the impact of regulation which affects business, those (safeguard measures) should be implemented'. This is a separate question as to whether those measures are first justified under the Safeguards Agreement. It s also required, pursuant to the Act under which it operates[44], to have regard to general policy guidelines outlined in Part 2 of the PC Act.

Notably, the appropriate policy response to facilitate adjustment in the pig meat industry, whether it is a safeguard measure (tariff or tariff quota) or an alternative policy option, is ultimately a matter for the government.

APL's views on possible appropriate measures to facilitate industry adjustment are outlined in further detail in section 6.

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[42] Article 3 states that 'the competent authorities shall publish a report setting forth their findings and reasoned conclusions reached on all pertinent issues of fact and law."

[43] Productivity Commission (1998) *Pig and Pig meat Industries: Safeguard Action Against Imports*, Inquiry Report, Report No. 3, 11 November 1998, p 67, 74.

[44] The Act requires the Commission, when carrying out its functions, to have regard to several general policy guidelines. These include, for example, having regard to encourage the development of Australian industries that are internationally competitive, to the need to recognise the interests of industries and consumers, to promote regional development, to recognise the progress made by Australia's trading partners in reducing both tariff and non-tariff barriers, for Australia to meet its international obligations and commitments.

7.3.1 "Best practice" regulation

The Australian Government *Best Practice Regulation Handbook* is explicitly cited in the Issues Paper as relevant to the Commission's assessment.

The Handbook provides guidance on the analysis and consultation which must be undertaken by ministers and their portfolios when developing regulatory proposals. It sets out general requirements on regulation, consultation, conduct of Regulation Impact Statements, and selection of an appropriate regulatory instrument. These are mandatory for all Australian government departments, agencies, boards and statutory authorities, including the PC.

Implicit in the requirements is 'a commitment by ministers and their portfolios to carefully consider, at an early stage, the case for acting in response to a perceived policy problem, including addressing the fundamental question of whether regulatory action is required, or whether the policy objectives can be achieved by alternative measures which would involve lower costs for business and the community".[45]

Best practice regulation requirements mandate that where a regulatory proposal is likely to have a "significant impact" on business and individuals or the economy (whether in the form of compliance costs or other impacts), a detailed analysis must be undertaken and documented in a Regulation Impact Statement (RIS).[46] If the impacts include medium or significant business compliance costs, the RIS should include a full (quantitative) assessment of these costs.[47] Where a regulatory option restricts competition, departments and agencies must ensure that the RIS considers whether that option generates a net benefit and is the only way of achieving the policy objective. Where a proposed regulation has a direct bearing on international trade or export performance, a Trade Impact Assessment should be incorporated into the RIS. The Trade Impact Assessment should summarise the impact of regulatory options and proposals on exporters, and assess the overall impact on Australia's international trade.

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[45] As noted by the PC in tis Issues Paper, key principles 'include that governments should not act to address problems until a case for actions has been clearly established and that a range of feasible policy options have been identified and their potential communitywide costs and benefits assessed'.

[46] An RIS is defined as 'a document that details the regulatory impact assessment process, including the problem requiring government intervention, the proposed regulation and its alternatives, the impacts of the different options, and consultation with stakeholders'.

[47] This can be assessed using the Business Cost Calculator (BCC) or an approved equivalent.

7.3.2 Impacts on other parties

The Issues Paper notes that some of the relevant impacts on other parties to be considered might be on downstream processing industries, importers, local exporters and consumers as well as foreign exporters and governments. Consistent with the requirements of the regulatory handbook it also points out that the Commission must address the impact n the Australian community generally.

Notably many of these issues were also addressed by the PC in its earlier inquiry in 1998, and again in the 2004 inquiry into the Industry. [48] In that case it considered the impact of safeguard measures and internationally competitive industries, industry adjustment, users and consumers, regional development and Australia's international obligations and commitments.

The 1998 inquiry held that, considering the broad policy guidelines and impacts on other parties, safeguards were unlikely to be the most effective approach for assisting the pig meat industry to adjust.

It can be demonstrated that many of these findings no longer hold in the current circumstances. The situation facing the pig meat industry today not only points to a clear case justifying safeguard measures, but also supports their imposition as a legitimate means for remedying injury.

Industry adjustment

The PC noted in its 1998 report that tariffs and quotas are blunt instruments and do not create incentives for producers to adjust. It stated that safeguard actions involving tariffs and quotas are a blunt and indirect way of providing assistance, because they assist producers regardless of whether or not they are profitable.[49]

Tariffs can be an effective tool for adjustment if set to reduce progressively, however. Progressively exposing the domestic industry to full import competition by gradually reducing tariffs gives industry room to take steps to adjust.

[48] Productivity Commission (2004) *Australian Pigmeat Industry*, Draft Report, Melbourne, p 135.

[49] *Ibid*, p 136.

Tariffs are also the only effective mechanism that can be applied at short notice to assist the industry. The administrative costs of implementation are low as the infrastructure is already in place.

International competitiveness

The 1998 PC report suggested that safeguards could inhibit international competitiveness - in order to become internationally competitive, the industry must be exposed to world price signals. Blocking these signals, even temporarily, will not encourage efficiency and will encourage a home market bias toward domestic sales.[50]

Any structural adjustment measure can delay exposure to competitive processes; safeguard measures are not unique. They avoid the "double adjustment" problem of potentially competitive producers exiting the industry.

It could also be argued that subsidised imports are not representative of internationally competitive processes in the first place: arguably imports from Europe and North America are subsidised by governments which prevent the domestic industry from being exposed to world market signals in the first place.

Impact on consumers

The PC noted that safeguard measures have adverse impacts on consumers as tariffs will have the effect of increasing prices for processed pork products.[51]

Structural adjustment measures should be recognised as an acceptable temporary and short term cost to consumers to achieve the long run aim of improving competitiveness of the industry.

The Australian pig meat industry is in crisis and the only short term action that can be taken to bring some relief to this situation is the imposition of provisional and general safeguards. The clear consequence without safeguards is an industry incapable of supplying its customers (domestic and export markets) for whom imports are not an option due to quarantine restrictions (such as the domestic fresh pork market).

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[50] Productivity Commission (1998) *Pig and Pigmeat Industries: Safeguard Action Against Imports*, Inquiry Report, Report No. 3, 11 November 1998, p 68.

[51] *Ibid*, p 71.

For this reason, the imposition of safeguard tariffs on imported frozen pig meat to avoid this industry collapse is clearly in the public interest. It could be argued that tariffs will lead to increased consumer prices, and this is possible. The likely extent and temporary nature of these tariffs however will have a very minor impact on consumer spending, and could be seen as a reasonable investment by the consumer and tax payer in securing the ongoing supply of a quality fresh pork product, and to keep the associated jobs and support for Australian families flowing through the pig meat supply chain.

Without safeguards, the consequential collapse of the domestic industry will increase our reliance enormously on the imported pig meat and the overseas markets supplying them. The nature of pig production, with the high level of investment required for entry and the delays in positive cash flows after entry decisions means that ramping up local production at a later stage is not only difficult, but still unattractive to many. Potential future scenarios of reduced subsidies in the overseas supplying countries leading to higher prices, shifting exchange rates, product quality problems, overseas disease outbreaks or product shortages would leave our domestic consumers highly vulnerable to increased prices or lack of supply without the real option of buying locally. For this reason, a strong and competitive local pig production industry in this country is in the public interest, and only safeguards can contribute in the short term to saving it.

Industry restructuring and competitiveness

The PC asserts that safeguard measures could slow industry restructuring, vital for regional development and enhanced competitiveness. Import restrictions, by raising domestic prices, could slow the adjustment process by encouraging some marginal producers to remain in the industry, and by discouraging exports.[52]

Safeguard measures can help promote industry adjustment, however. Safeguard measures give producers relief from competition to facilitate an orderly exit for consolidation of the industry. Without them in this case the industry risks a complete collapse, and present market forces will not result in a managed restructure.

International credibility in trade negotiations

The Productivity Commission argued that the imposition of safeguards could diminish Australia's credibility to seek liberalisation of agricultural trade. It stated that extensive use of safeguard measures could be considered as contrary to the spirit of the international

[52] Productivity Commission (1998) *Pig and Pigmeat Industries: Safeguard Action Against Imports*, Inquiry Report, Report No. 3, 11 November 1998, p 68.

trading system.[53] Safeguard measures could harm Australia's capacity to seek reductions in overseas trade barriers.[54]

This is unfounded. Safeguards, and provisional safeguards are entirely consistent with international obligations under WTO trade rules. They are an acceptable trade remedy available to all 151 WTO members. The PC acknowledged in its 1998 report that it is important that Australia makes full and effective use of measures legitimately available to it under those rules.[55] There is no evidence that the use of safeguard measures undermines the capacity of the government to seek reductions in trade barriers. The pig industry should not be made bear the brunt of the national cost of being seen to be pro-free trade, especially when an action consistent with WTO trade rules is available and justified. Australia will only act in compliance with WTO rules.

Safeguard measures are actively used by WTO members, including against Australia by its major trading partners. Since inception of the WTO Agreement on Safeguards 159 safeguard investigations have been initiated (up to October 2007), with 82 safeguard measures imposed. Four safeguard measures are currently in place. The US has applied safeguards on fresh, chilled or frozen lamb meat from Australia and New Zealand. Safeguards have been imposed on combed cotton yarn from Pakistan, on textiles and apparel products from China. It has taken over 14 provisional safeguards on steel products while (over 21) safeguard investigations took place. Provisional safeguards have also been applied against farmed salmon and canned mandarins. Japan applied safeguard measures in 1995, 1996, 1997, 2001, 2002 and provisional safeguards on farm products in 2001.

Measures imposed are accepted as a legitimate response to import surges. Of the 82 measures imposed, only 34 disputes have been initiated.

WTO experience on safeguards disputes emphasises the importance of conducting an investigation in accordance with the requirements of the Agreement. Less than half of the disputes issues have had rulings issued to date (with 17 still awaiting a decision, and 1 resolved by a mutually agreed solution). Of the 16 rulings, the safeguard measure was found to be imposed inconsistent with (at least some) provisions of the Safeguards Agreement on all 16 occasions. However, of these 16 cases, half dealt with the same

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[53] *Ibid*, p 74.

[54] Productivity Commission (2004) *Australian Pigmeat Industry*, Draft Report, Melbourne p 137.

[55] Productivity Commission (1998) *Pig and Pigmeat Industries: Safeguard Action Against Imports*, Inquiry Report, Report No. 3, 11 November 1998, p 75.

measure but by different parties (specifically, United States' definitive safeguard certain steel products).

Adverse rulings in disputes will not necessarily negate the safeguard measure imposed. In not all cases was the country imposing the measure required to lift the safeguard as a result of the ruling. Of the 16 rulings, in only 12 cases the safeguard measure was lifted. In another 3 cases, changes to the measure were made as a result, but measures remained in force. In one case, the outcome is still to be resolved.

Impacts on exporting countries

The PC raises the issue of exporting countries in its Issues Paper, citing the possibility of retaliatory actions arising from a failure to reach an agreement on compensation. This issue was also raised in the 1998 enquiry where the PC noted that concessions to affected exporter countries could be hard to agree on.[56] It argued that actions might also encourage retaliatory action in either the pig meat industry or other industries.[57]

This issue is not only irrelevant to the question of whether safeguards are justified, but is also unfounded. Agreements on compensation with exporter countries are made by many WTO members when safeguard actions are taken and have been made by Australia in the past without a threat of a retaliatory action.

### 7.4 Safeguard actions and preferential trading arrangements

The PC Issues Paper points to modified obligations that apply for the imposition of safeguards under the Australia-United States free trade agreement (AUSFTA) as a relevant issue. The FTA provides that when taking a general safeguard action (under WTO rules as opposed to that under the AUSFTA), Australia may exclude imports originating from the US 'if such imports are not a substantial cause of serious injury or threat thereof.'[58] "Substantial cause" is defines as 'a cause which is important and not less than another cause'.

Are imports from the US a "substantial cause" of serious injury of threat of serious injury?" Are they an 'important" cause? Important is not further defined in the agreement. According to the Oxford Concise Dictionary it can be understood to mean 'having a great

[56] Productivity Commission (2004) *Australian Pigmeat Industry*, Draft Report, Melbourne p 136.
[57] *Ibid*, p 137.

[58] Article 9.5 of the Australia-United States Free Trade Agreement.

effect or of great value'. "Great" is defined as 'above average in amount, extent or importance'.

As noted in Section 1, imports from the US have increased markedly between 2001-02 and 2006-07. Over the period July/June 2001-02 imports were 1,361,499 kg. By 2004-05 they had increased to 14,334, 136 kg and by 2006-07 to 27, 866,403 kg. Their share of imports over this period grew from just 3 percent in 2001-02 to 26 percent by 2006-07 (see Chart 2, Question 1).

As demonstrated in Section 5, increases in imports from all sources (Canada, Denmark and the US) have caused serious injury to the domestic industry. However, the exact extent to which increases in imports from the US have contributed to injury, compared to increases from other sources, is hard to measure. Both the absolute increases in the level of imports from the US and the magnitude of the share of that of all imports provide some indication. These demonstrate that increases in US imports have clearly been of "great effect" in causing damage to the industry.

Are imports from the US a cause which is "not less than another cause"? In other words, are imports from the US of the same or of greater effect in causing injury to the industry than other factors? Certainly in recent years (since 2004) they could not be said to be a lesser cause of injury than imports from Denmark or Canada. During this time the amount of imports and their share of all imports which are causing injury have increased dramatically.

On this basis it can be concluded that imports originating from the United States are a substantial cause of serious injury. Based on current levels of increases, they would also constitute a substantial cause of any threat of injury. It is unlikely therefore that imports from the US could be excluded from any safeguard actions taken by Australia.