# Productivity Commission

# Pigmeat Safeguards Inquiry

prepared by

**Primary Industries and Resources SA**

**Department of Trade and Economic Development**

for

**Government of South Australia**

**28 November 2007**

Government
of South Australia

# Executive Summary

The South Australian pork industry operates within a National and Global context and is often influenced by factors outside its State borders. In 2004, the SA Government had taken a strategic approach to the development of the pork industry in the State. Primary Industries and Resources South Australia (PIRSA) partnered with the pork industry to develop the SA Pork Industry Strategic Plan for 2010, whereby the gross value of the State's production would be increased by around 50% by 2010. Since that time, the Minister for Agriculture, Food and Fisheries established the Pork Industry Development Board.

Up until the recent spike in pork imports, the SA industry has been relatively stable with many businesses capturing the efficiencies that are associated with dedicated enterprises, and has been steadily working towards achieving the targets in the SA Pork Industry Strategic Plan for 2010. The industry has implemented a range of innovative strategies including marketing campaigns and product development to increase consumer awareness and acceptance of pork meat, particularly in the fresh meat segment. As a result, domestic consumption of fresh pork has steadily grown over the past few years.

However, these gains to the SA pork industry are likely to be seriously affected if the industry does not survive the current price and income crisis. It is apparent from the analysis in the following submission that a number of coinciding factors have led to suppressed pigmeat prices and falling pork farm incomes. The recent spike in imports has come at a time when domestic and global feed grain prices are at all time highs, the Australian dollar is at its highest level in over two decades and almost at parity with the US dollar and subsidies paid to pork producers in importing countries appear to be higher than in Australia.

The SA government recognises that this State's pork sector is experiencing financial difficulties caused by suppressed farm-gate prices and considers that a combination of measures such as Commonwealth structural adjustment schemes and strategies designed to influence the demand and supply of pork are warranted.

# 1 SA PORK INDUSTRY – WORKING TOWARDS ITS GOALS

## 1.1 A strategic approach to industry development

The South Australian pork industry operates within a National and Global context and is often influenced by factors outside its State borders. However, the SA Government has taken a strategic approach to the development of the pork industry in SA. In 2004, Primary Industries and Resources South Australia (PIRSA) partnered with the pork industry to develop the SA Pork Industry Strategic Plan for 2010. The plan describes a preferred future for the industry and sets a number of targets including:

- Increase Gross Food Revenue from $427m to $668 m
- Increase weekly marketable pigs from 18,000 to 27,000
- Adding value of dressed weight from $2.40 to $2.70 kg CWE
- Increase dressed carcase weight from 70kg to 72kg
- Increase in sows from 53,800 to 76,300
- Ensuring skilled management and staff
- Improving the relationship with community

Since that time, the Minister for Agriculture, Food and Fisheries established the Pork Industry Development Board (PIDB). The PIDB consists of a number of industry stakeholders with representation from along the value chain. The role of the PIDB is not only to provide strategic advice to the Minister, but also oversee and monitor the implementation of the Strategic Plan.

To identify areas of priority, the PIDB and PIRSA are using a "rate limiter" concept. A "rate limiter" is an existing condition or problem that restricts the rate of growth i.e. it inhibits the realisation of the opportunity to achieve the goals or aims of the industry. By applying their intimate knowledge and experience of the industry, the Board continues to identify and implement strategies that contribute to overcoming their rate limiters.

## 1.2 An industry working towards its goals

In 2005/06 SA had approximately 51 000 sows which represents about 17% of the National herd. The number of businesses where the major source of income is from pigs has remained relatively stable over the past five years, whilst those businesses with pigs as a secondary enterprise have been steadily declining (Figure 1). Again, these businesses represent about 15-17% of the total number of Australian enterprises.

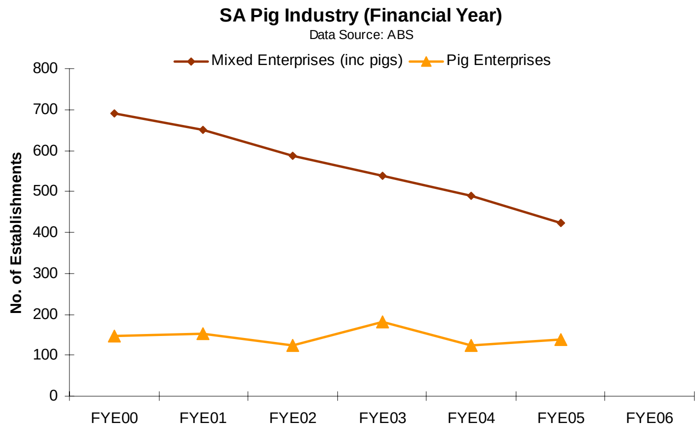


**Figure 1: Pig establishments in South Australia**

This suggests that the core production sector, up until now, has been relatively stable and these businesses are capturing the efficiencies that are associated with dedicated enterprises. This is reflected in the steady upward trend of the Farmgate Food Value (Figure 2).

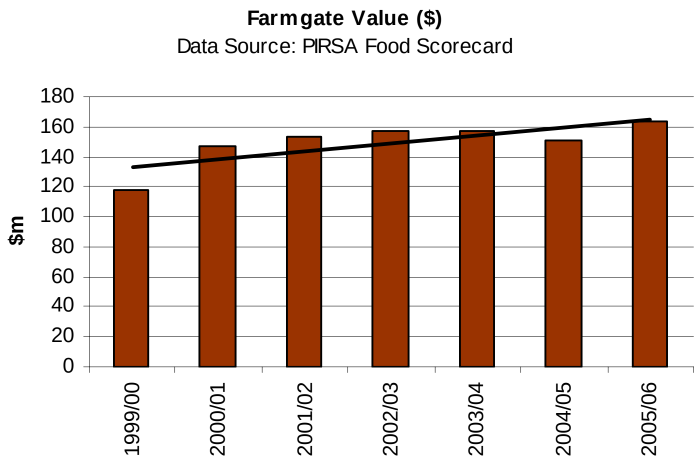


**Figure 2: Farmgate value of the pork industry in SA**

SA has two of Australia's most recently built pork export processing facilities. These two businesses, along with an average carcase weight (74.7kg) that is higher than the National figure (71.8kg), have contributed to a steady increase in the processing of pork in SA (Figure 4). For the 2006/07 year, SA's contribution to National processing was greater than 20%.

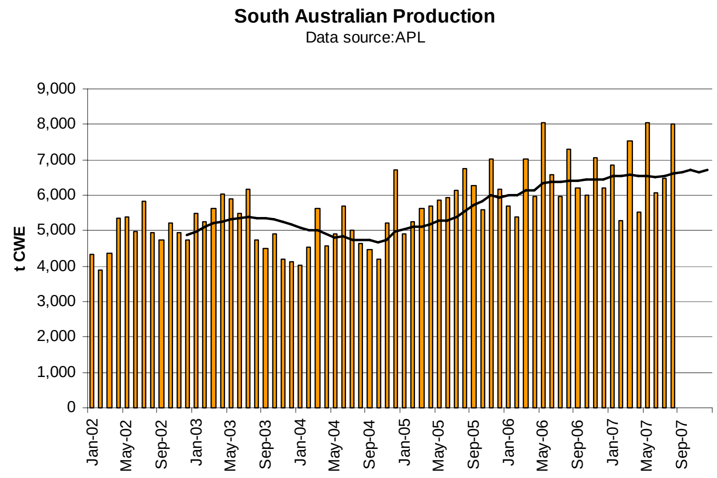


**Figure 3: South Australian pork production**

This is a remarkable result given that one of these abattoirs experienced a major fire in early 2007 with all production ceasing from that site. As well as showing the growth in value of the South Australian pig industry, Figure 4 demonstrates the change in structure of the industry for that period. The substantial increase in processing has seen a decline in revenue from interstate live sales coupled with an even greater increase in the value of net interstate processed sales and the emergence of overseas processed exports. Retail and service sales have only grown marginally during the period shown.

In summary, South Australia's pork industry is successfully restructuring, growing and working towards the achievement of many of its targets. Over the past six years the Gross Food Revenue for the pork industry has grown from $347 million in 2000/01 to $573 million in 2005/06 (Figure 4).

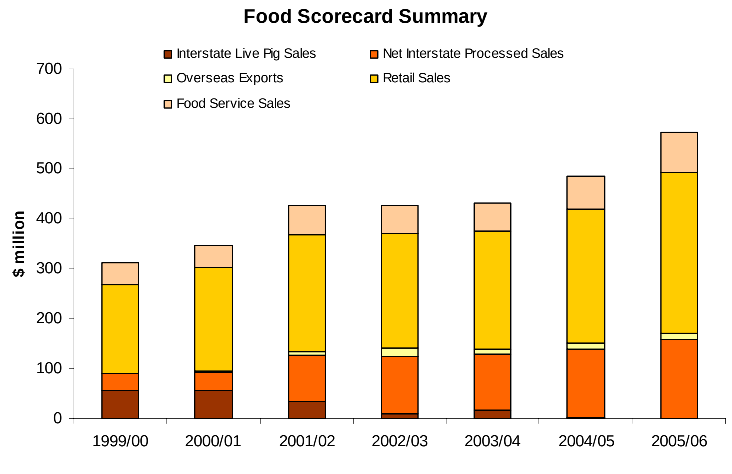


**Figure 4: SA pork industry food scorecard**

# 2 CHALLENGES TO CONTINUED SUCCESS

Up until the 2006/07 financial year, the SA pork industry has been steadily working towards achieving the targets in the SA Pork Industry Strategic Plan for 2010. Nevertheless, the industry is currently facing a number of challenges that have the potential to significantly impact the industry both immediately and into the future.

## 2.1 Changing demand and supply mix

### *2.1.1 Domestic consumption*

The industry has implemented a range of innovative strategies including marketing campaigns and product development to increase consumer awareness and acceptance of pork meat, particularly in the fresh meat segment. As a result, domestic consumption of fresh pork has steadily grown over the past few years (Figure 5). Consumption per capita of processed pork on the other hand has varied from year to year. The average per capita consumption of pork over the past four years has been 22kg per person CWE.

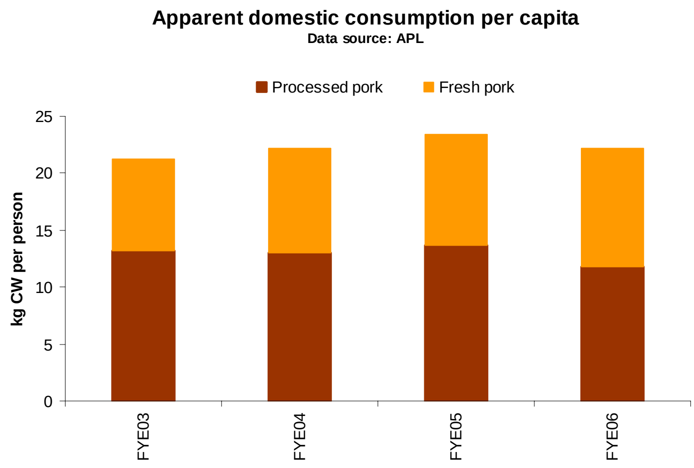


**Figure 5: Consumption per person of fresh and processed pork**

### *2.1.2 Imports of pigmeat*

In 2006/07 imports of pork directly into SA ports was a negligible 43 t SW. However, given the nature of the industry, particularly in the wholesale and retail sectors, the industry in SA is not immune to the influences that imports have on the domestic scene. The majority of imported frozen pigmeat lands in the Eastern States, where it is further processed and distributed across Australia. Current estimates suggest that in 2006/07 imported products will satisfy greater than 60% of the available market in processed pork. It should be recognised that there are a number of products in the market that cannot use imported products, which suggests there is potentially a market cap on imports. It is likely that this cap is in the vicinity of 80% of the processed market.

Imports of pork into Australia have been increasing since 1998 with significant spikes mid year in 2005 and 2007 (Figure 6). In particular, imports jumped by greater than 40% in the 2006/07 financial year. The continued strength of the Australian economy and subsequently the Australian dollar, suggests that imports will continue to be an attractive option.

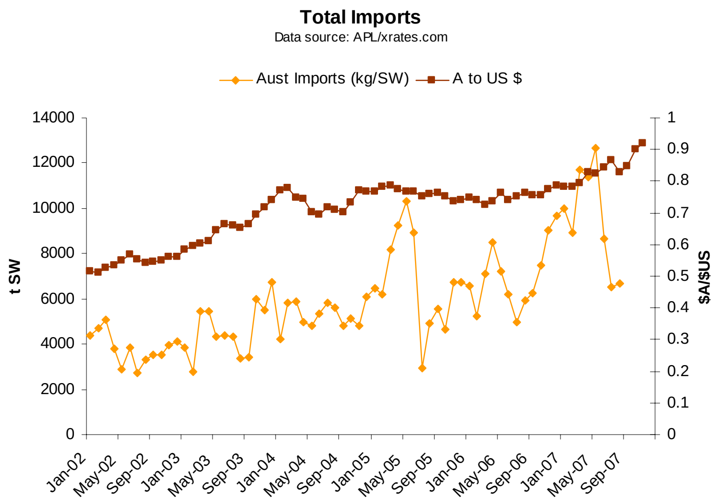


**Figure 6: Pork imports into Australia and the $A/$US exchange rate**

The most recent spike resulted in record levels of imports that were not predicted by either industry or Australia's forecasting body – ABARE (Figure 7). In fact, the ABARE forecast (released in March 07) did not predict the import levels reaching the records of 06/07 for at least another 5 years.

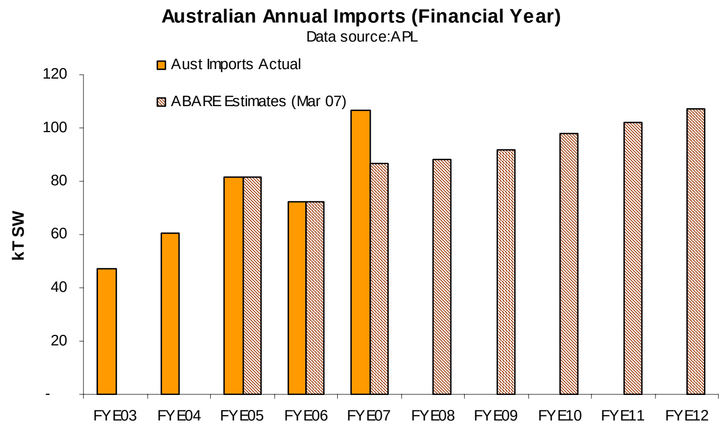


**Figure 7: Yearly imports of pork into Australia along with ABARE forecasts**

The latest OECD publication on Agricultural Policies suggests that in some cases the support policies in some countries (Table 1) may be a source of competitive advantage, particularly if there has been a recent policy change. This warrants further investigation by the Commission.

**Table 1: OECD Agricultural policy summary**

| *Country* | *%PSE* | *%SCT* |
|---|---|---|
| Australia | 6 | 0 |
| Canada | 23 | 1.2 |
| European Union | 32 | 14.7 |
| United States | 11 | 0 |

*Source: Agricultural Policies in OECD Countries: Monitoring and Evaluation 2007*
*PSE – Producer Support Estimate*
*SCT – Single Commodity Transfer for pigmeat*

### 2.1.3 *Exports*

Whilst imports have been increasing, export levels have remained relatively consistent in volume and value since 2003/04 (Figure 8). In 2006/07, exports from SA made up less than 10% of National exports and less than 7% of SA production.

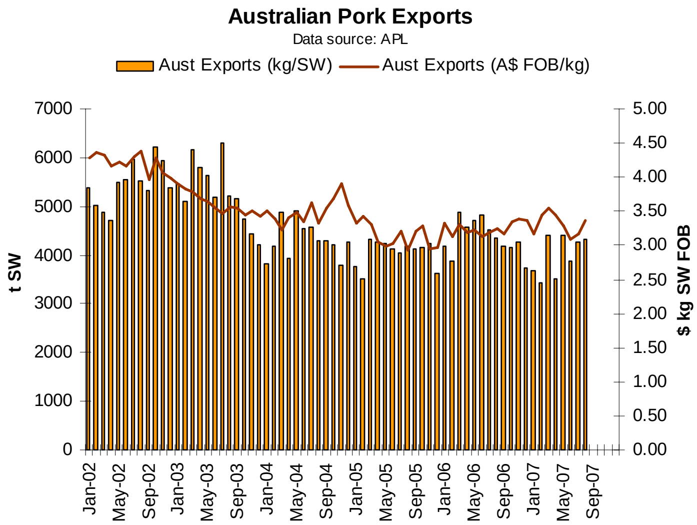


**Figure 8: Monthly pork exports from Australia**

### 2.1.4 *Change in supply demand mix*

Given the consistent level of domestic production, consumption and exports nationally, the recent spike in import volumes is likely to be creating an over supply of pork on the domestic market. Furthermore, it's likely that these imports have created significant levels of pork in storage. These factors are combining to place downward pressure on the domestic price of pigs.

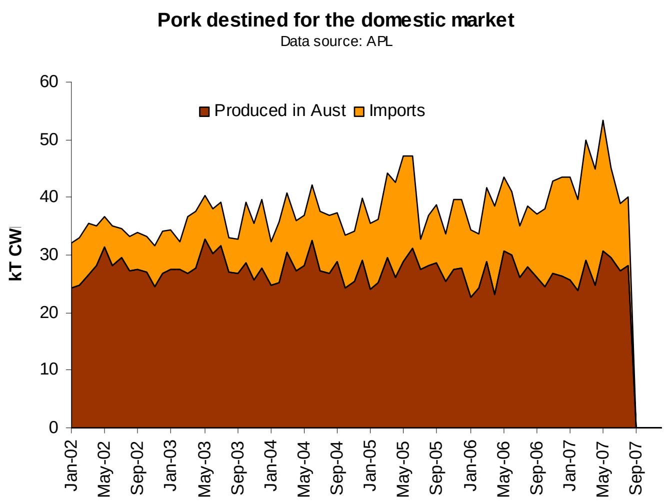


**Figure 9: Import/Domestic production share of Australia's consumption**

Figure 9 demonstrates the elevated levels of imported pork that are intended for the processed domestic market potentially creating an oversupply of pork. Given the time lag between intent to produce a pig and marketing it (up to 12 months), it is not practical for production to be 'switched off' immediately to compensate for market oversupply. As such many industry representatives are suggesting in the short-term prices are likely to remain low. The SA contract price for pork is the lowest it has been for some years (Figure 10), especially in the period from week 28 to 43 (even allowing for the apparent seasonality of prices, which sees prices trough during the winter months).

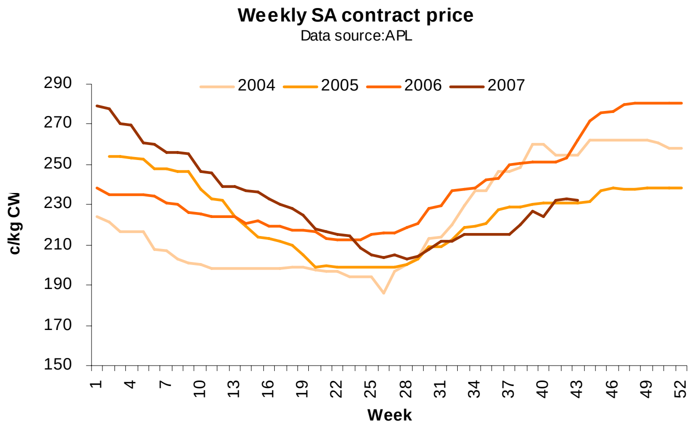


**Figure 10: SA contract price for 75.1 - 85kg CWE pigs**

Further evidence that the recent record levels of imports are likely to be suppressing the domestic prices for pigs can be seen in Figure 11 which compares the quarterly CPI index of pork (both fresh and processed) to a number of commodities that are not subject to import competition (milk, eggs). It appears that as the cost of production of eggs and milk has increased, the retail price has also increased which goes someway to alleviating the pressure on the producer. However, processed pork (bacon and ham) retail prices remain relatively steady indicating that imports may have played a part in suppressing farm-gate prices for pork.

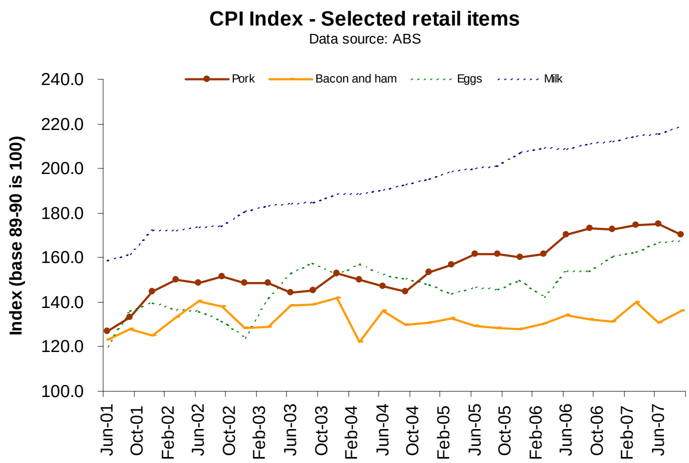


**Figure 11: CPI index for selected retail items in SA**

## 2.2 High cost of production.

The cost of grain is significant in the production of pork. Feed grain costs have risen to all time highs, with a 40% increase on 2006 prices (a year where prices were already high) for major feed grains including barley (Figure 12). These high prices are a consequence of local and global supply shortfalls for two years running due to below average production and global exports from as a result of adverse weather, increased demand for grain from emerging economies and new demand created by alternative energy production, especially in the United States where significant quantities of corn have been diverted to ethanol production (reflecting the US domestic renewable energy policies). All of this has combined to reduce world stockpiles to the lowest levels for several thirty years.

Of significant concern is the ongoing impact of these energy policies on grain prices and the ability of pork producers to adjust, but it can be expected that increased area sown in the major exporting countries in response to the higher prices will succeed in replenishing world supplies and global prices retreating closer to normal levels by late 2008 into 2009 (provided no further production impacts occur in major grain exporting countries). Grain futures which traded at all time highs, in excess of 900c/bushel this year, have already declined to 600c/bushel in anticipation of a return to normal supply/demand with increased areas of crop (corn) in US, Canada (wheat and feed grains).

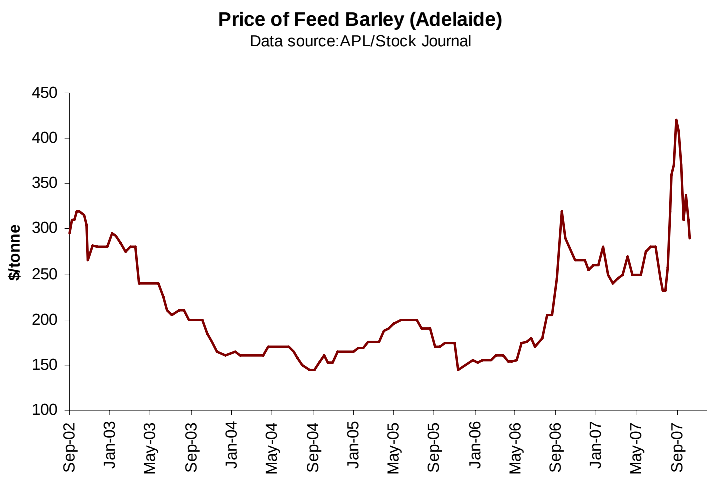


**Figure 12: Price of barley (Adelaide)**

Based on the latest crop production estimates by PIRSA, it appears, as though there will be an adequate supply of most feed grains for the local market. However, shortages in the Eastern States may introduce further competition for the product that in turn may lead to sustained high domestic feed grain prices. With the beginning of harvest, prices for feed barley in SA have eased somewhat and are likely to ease further but this issue will remain a significant challenge to the pork industry. Global prices will always provide a base line price at "export parity", driven by the costs of buying and importing grain from the global market. As global prices retreat, the domestic prices will follow, as the potential to import cheaper grain will override domestic demand driven prices.

Figure 13 illustrates the approximate percentage cost of feed in relation to the price received per kilogram of pork produced (CWE) at the production level. In this case, feed costs are based on the:

- Adelaide cash price for feed barley
- $100 per tonne for commercial pelleting, transport, feed additives etc
- Whole of herd feed conversion ratio of 4:1

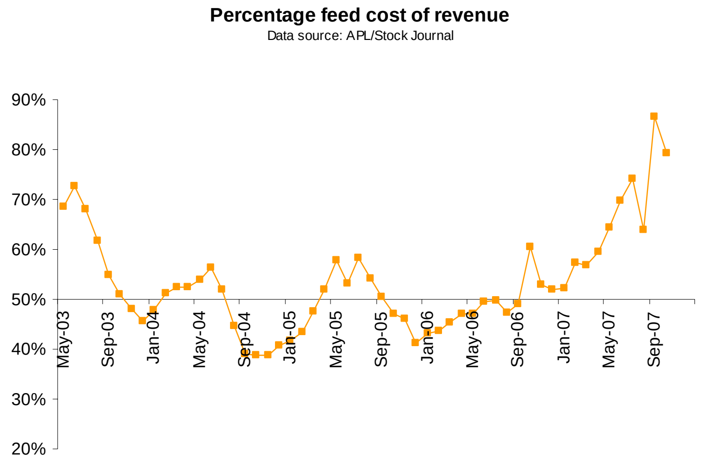


**Figure 13: Cost of feed as a percentage of return**

The average percentage cost from September 2003 until September 2006 is below 50%. The dramatic increase in the cost of feed over the past 12 months highlights the sensitivity of the cost of production to feed prices. Clearly high feed grain prices have placed downward pressure on pig producers' returns in South Australia.

# 3 THE POTENTIAL IMPACT OF THESE CHALLENGES

The impact of the spike in imports combined with the current high cost of production is having a significant impact on the production sector in SA. Figure 14 compares the approximate cost to produce one kilogram of pork with the price received for that kilogram of pork. The cost of production is based on the following broad assumptions:

- The Adelaide cash price for feed barley
- An additional $100 per tonne for commercial pelleting, transport, feed additives etc
- A whole of herd feed conversion of 4:1
- $1 of other cost per kg of pork produced (labour, health, housing etc)

Clearly, the past six months have been difficult for those businesses exposed to the higher costs of production. Of further concern is that over the past 18 months there have only been a few months where a return might be possible and it appears this would not adequately compensate for current conditions.

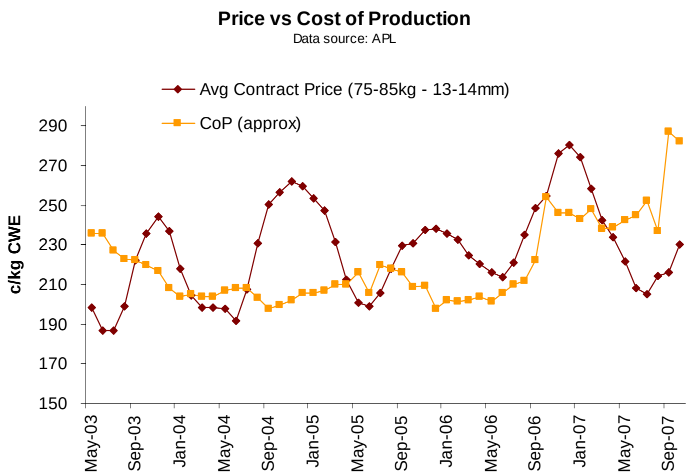


**Figure 14: Approximate cost of production of pork**

There is a general consensus that those pork producers exposed to low returns and a high cost of production are losing money in the order of $10-$40 per pig sold. This represents a combined loss at the production level in SA of between $180 000 and $720 000 per week (based on 18 000 South Australia pigs being processed per week).

Consequently producers are implementing a range of strategies that include; exiting the industry (either permanently or for the short term), reducing or ceasing mating, or continuing on as usual and taking the losses in the belief that the returns will be there in the long run.

The repercussions are that there is likely to be an immediate and medium-term contraction in the production sector in SA. Recent anecdotal evidence suggests that up to 10% of SA sows may go out of production in the short term and potentially more in the long term. If 10% of sows are removed from production its likely to reduce the Farmgate Food Value by approximately $15 million (Table 2). Given the flow-on and multiplier effects of falling farm incomes, this will impact negatively not just on the State's rural sector, but also other sectors as well, leading to potential losses in overall output, value added production and possibly employment.

**Table 2: Sensitivity of Farmgate Food Value to loss of sows**

| Production Revenue ($A m) | | *Avg Contract Price (c Kg CW)* | | | |
|---|---|---|---|---|---|
| | | *$2.15* | *$2.30* | *$2.45* | *$2.60* |
| *Reduction in sow numbers* | *52 635* | $152m | $163m[1] | $174m | $184m |
| | *↓5 000* | $138m | $148m | $157m | $166m |
| | *↓10 000*[2] | $123m | $132m | $141m | $149m |
| | *↓15 000* | $109m | $117m | $124m | $131m |

Source: PIRSA Food Scorecard
Notes: 1. Reported 2005/06 figure
2. The equivalent of approximately a 20% reduction in SA sows

## 4 WHAT CAN BE DONE?

It is apparent that a number of coinciding factors have led to suppressed pigmeat prices and falling pork farm incomes. The recent spike in imports as a result of the strengthening Australian dollar is coinciding with exceptionally high costs in producing pork.

Though it's difficult to separate the effects of these factors on suppressed prices and incomes, it's reasonable to conclude that the recent rise in imports has played a part in the industry's current troubles, but that it is not the sole contributing factor. In that sense, the situation today differs markedly from the situation in 1998, the time of the last Productivity Commission Safeguards Inquiry into the Australian pigmeat industry. At that time, the industry did not face such high costs of production and the Australian dollar was much lower than it is today.

The SA Government recognises the strong contribution external trade makes to the State's economic growth and prospects and therefore has a general policy that supports free trade. At the same time, the SA government recognises that the State's pork sector is experiencing financial difficulties and measures are required to facilitate an orderly adjustment to current pressures.

As such, the South Australian Government suggests that measures other than trade-related ones may be the best way to bring about relief to the industry, as well as facilitate structural adjustment. These measures should be income-related (as they are not trade-distorting) and designed to influence the demand and supply of pork.

On the demand side, actions such as labelling of fresh and frozen pork as Australian or imported would do much to raise consumer awareness about the country-of-origin of the products they are consuming, as well as enable them to make informed choices. This would also allow for increased differentiation of the domestic product. In addition programs devoted to marketing of chilled and/or frozen pork (both domestic and for export) would also help further define the unique characteristics of the Australian product (eg clean and green) leading not only to enhanced sales but possibly to increased margins brought about by catering to niche markets.

On the supply side, continued and perhaps increased support of research and development programs such as the Pork Cooperative Research Centre, with a focus on cost-reductions and innovations in production would contribute to making the industry more competitive and, over time, better able to deal with import shocks in the future.

Finally, with regard to income relief, the SA government recognises that pork producers are currently experiencing severe financial difficulty through little fault of their own making, and so suggests the Commonwealth consider setting aside funds for a 'pork adjustment restructure package', similar to the approach taken for the dairy industry (in 2000) and the sugar industry (in 2004/05). As was the case for dairy and sugar, these funds would be used to enable those producers that wished to exit the industry to do so with dignity, and at the same time enable those producers that wished to remain in the industry to use the funds for on-farm improvements and/or training. This would make the businesses that remained in the industry more competitive and better able to deal with trading challenges in the future.

Overall, these suggested income and supply and demand side measures would support the strategic approach PIRSA has taken in its strategic plan for the industry to 2010.